No. 77-1279

IN THE

Supreme Court of the United States

October Term, 1977

MALCOLM K. FLESCHNER, WILLIAM J. BECKER, HAROLD B. EHRLICH and FLESCHNER BECKER ASSOCIATES,

Petitioners,

v.

ROBERT ABRAHAMSON and MARJORIE ABRAHAMSON,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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March 14, 1978

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Petitioners Malcolm K. Fleschner, William J. Becker, Harold B. Ehrlich and Fleschner Becker Associates [1] respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered on February 25, 1977, and modified on rehearing on January 6, 1978.

Opinions Below

The opinion of the Court of Appeals (A3-49) [2] is unofficially reported at [1976-1977 Transfer Binder] FED.

[1] These petitioners and Harry Goodkin & Co. were defendants in the District Court.

[2] The opinions below are reproduced in the appendix to this petition, and "A —" page references are to that appendix.

SEC. L. REP. (CCH) ¶ 95,889. The Order of the Court of Appeals modifying that opinion (A50-52) is not reported. The opinion of the District Court (A54-74) is reported at 392 F. Supp. 740.

The interim opinion of the Court of Appeals (A75-78), which requested the parties and the Securities and Exchange Commission as amicus curiae to file supplemental briefs in view of "the importance and novelty of the issues" (A78) raised under the Investment Advisers Act of 1940, is reported at 537 F.2d 27.

Jurisdiction

The judgment of the Court of Appeals was entered on February 25, 1977, and an order granting in part a timely petition for rehearing was entered on January 6, 1978. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

Questions Presented

Respondents, former limited partners of a privately held investment partnership, seek damages from the limited partnership, its general partners and accountants under the Investment Advisers Act of 1940 on the claim, supported only by respondents' uncorroborated oral testimony, that had petitioners not omitted to disclose that the partnership's investments included unregistered securities, respondents "would have" withdrawn from the partnership sooner and as a result would have increased by another $1,254,800 their net profit of $289,000 on an investment of $599,000.

Two important questions are presented:

1. May a private right of action for damages be implied under the Investment Advisers Act of 1940 to permit former limited partners of a closely held, predominantly family investment partnership to sue the general partners as purported investment advisers, even though (i) the Act contains no express provision for any damage actions and confers no jurisdiction on the federal courts to hear actions at law and (ii) the legislative history evidences a clear congressional intention not to create private rights of action and Congress has consistently declined opportunities to do so?

2. If such a right of action is implied, may respondents recover damages merely on the claim that they "would have" liquidated their partnership interests at a larger profit if they had withdrawn earlier, even though they realized a substantial profit on their investment, sustained no "out-of-pocket" loss, and do not allege that the petitioners were unjustly enriched by the respondents' failure to withdraw?

Statutes Involved

Sections 206 of the Investment Advisers Act of 1940, 54 Stat. 852, as amended, 74 Stat. 887, 15 U.S.C. § 80b-6, and Section 214 of that Act, 54 Stat. 856, 15 U.S.C. § 80b-14, are set forth in the appendix to this petition (A1-2).

Statement of the Case

This case arises out of the respondents' participation in The Fleschner Company, now Fleschner Becker Associates ("FBA"), a private investment partnership organized in 1965 by their former friend Fleschner to invest collectively his and his family's capital. Respondents remained limited partners through September 1970. On withdrawal respondents realized a profit of $289,000 on their investment of $599,000, a return of 48%.

This action was commenced in January 1971 against certain general partners of FBA (the petitioners here) and

the firm of accountants that prepared FBA's financial statements for the years 1966, 1967 and 1968. Respondents claim (i) that petitioners omitted disclosure of the fact that FBA's investments had, since January 1967, included unregistered securities, and (ii) that had they known of such investments they would have withdrawn from FBA in September 1968, when their proportional share of FBA's assets reached peak value. Respondents claim they would have thus realized an additional net profit of $1,254,800. Respondents sued under § 10(b) of the Securities Exchange Act of 1934 and § 206 of the Investment Advisers Act of 1940, seeking as damages the difference between what they realized on withdrawal in 1970 and what they would have realized had they withdrawn in 1968.[3]

The District Court granted petitioners' motions for summary judgment on the ground that respondents had sustained no damages (A65-74).

On appeal, the Court of Appeals unanimously affirmed the dismissal of respondents' claim under § 10(b) and Rule 10b-5, not because of failure to allege compensable damages, but because of failure to allege fraud in connection with the purchase or sale of a security (A12):

> "[T]he requirement of fraud in connection with the purchase or sale of a security is not satisfied by an allegation that plaintiffs were induced fraudulently *not* to sell their securities. *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 737-38 (1975)."

Nonetheless, the Court of Appeals (2-1; Gurfein, J., dissenting on this point) held that respondents had an implied right of action for damages under § 206 of the Advisers

[3] Jurisdiction was allegedly based on 15 U.S.C. § 78aa and 15 U.S.C. § 80b-14.

Act, the first Court of Appeals to do so. The majority, ignoring the characteristics of this closely held, predominantly family investment partnership, further held that the general partners were "investment advisers" [4] to the limited partners, because they "managed the funds of others for compensation" (A15). Finally, the majority disregarded respondents' enormous profits and the absence of any out-of-pocket loss and fashioned an *ad hoc* measure of damages to be applied by the District Court on remand (A32-33).

In a vigorous dissent (A34-49), Judge Gurfein pointed out that the legislative history of the Advisers Act reveals that the Act " 'represented a compromise between the SEC and the investment advisory industry' " (A35) and in no manner supports implication of a private action for damages:

> "The legislative history of the Advisers Act indicates that it was a tentative attempt to effect a 'compulsory census' of investment advisers by requiring registration rather than to provide a full regulatory scheme." (A35)
>
> * * *
>
> "The attempted withholding of jurisdiction over actions at law in the Advisers Act [by Congress' deletion of any reference to 'actions at law' in § 214, the jurisdictional section] indicates that Congress was not intending to provide for *any* liability beyond injunctive relief." (A37) (footnote omitted)
>
> * * *
>
> "[The fact that, in contrast to each of the other securities acts, Congress did not] provide for *any express* civil liability in damages . . . indicates rather that, in its cautious approach to the regula-

[4] "Investment adviser" is defined by § 202(a)(11) of the Advisers Act, 15 U.S.C. § 80b-2(a)(11).

"tion of investment advisers, Congress was not yet ready to impose *any* civil liability for damages." (A38-39)

The dissent also voiced concern that the court was creating a "claim for relief by judicial legislation, without the ability to define the outer limits of such a claim" (A44). The absence of such limits, the dissent stated, creates a

> "distinct danger that, by implying an open-ended private right of action, the court is giving the clients of investment advisers *carte blanche* to convert themselves from victims to defrauders." (A45)
>
> * * *
>
> "Implying a claim for relief without limitation will encourage actions against investment advisers for poor judgment, disguised by pleadings subtly implying fraud and deceit." (A48)

Finally, noting that the majority was affirming the dismissal of respondents' claim under § 10(b) of the 1934 Act because of their failure to satisfy the "purchase or sale" requirement reaffirmed by *Blue Chip Stamps,* the dissent urged that the Court

> "ought instead to leave the issue to Congress. To create an analogue to Section 10(b) without the requirement that the 'fraud' be 'in connection with the purchase or sale' of a security hardly gives broad effect to the policy considerations so clearly expressed in the majority opinion of the Supreme Court in *Blue Chip Stamps* and in Mr. Justice Powell's concurring opinion . . . . The majority specifies no limits to the civil liability under § 206 which it is in the process of creating over this dissent. Yet, it is simply extending 10b-5 by resort to a different statute." (A47)

Petitions for rehearing, with suggestions for rehearing in banc, were filed on three issues: (1) the implication of a

private right of action under § 206, (2) the holding that FBA's general partners were investment advisers, and (3) the measure of "damages." Rehearing was granted in part to allow further supplemental briefs from the parties and the SEC only on the second issue.[5] After receiving the additional briefs the majority adhered to its holding that the general partners are "investment advisers" but withdrew its earlier conclusion that they were advisers "to the limited partners" rather than the partnership itself (A51). In all other respects the petitions for rehearing were denied.

Reasons for Granting the Writ

I

This case, which has been in the federal courts since 1971, raises questions that the lower federal courts, the SEC, and the investment community have all recognized to be novel and important. The issue of an implied right of action under § 206 has now been considered by sharply divided panels of two Courts of Appeals,[6] is awaiting decision

[5] Eight entities in addition to the SEC filed briefs amicus curiae, either contemporaneously with the petitions for rehearing or the supplemental briefs on rehearing, or both: (1) Investment Counsel Association (the industry organization whose counsel had drafted the bill enacted as the Advisers Act in 1940), in opposition to the implication of a private right of action under the Advisers Act; and (2) Steinhardt, Berkowitz & Co.; (3) A.W. Jones & Associates; (4) A.W. Jones Company; (5) Avalon; (6) Euclid Partners; (7) Goodnow, Gray & Co.; and (8) Jubilee, all in opposition to the holding that general partners of investment partnerships are investment advisers.

After rehearing was granted another entity, National Venture Capital Association, sought to file a brief amicus curiae on the latter point, but was refused permission.

[6] The Fifth Circuit, relying on the decision below, recently determined, again over a vigorous dissent, that although *Blue Chip Stamps* barred plaintiff's 10b-5 claim, he nonetheless had an implied right of action for damages under § 206. *Wilson* v. *First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir., Feb. 2, 1978).

after argument in a third,[7] and seems likely to trouble the federal courts for years, unless resolved now by this Court.[8]

The decision below implied a right of action in disregard of the Act's distinctive legislative history and the policy considerations enunciated by this Court in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975). In doing so, the court created an open-ended cause of action for damages against "investment advisers," expansively construed by the court to include even investors managing their own funds in a common pool with the property of family and friends. The majority opinion vests rights to sue in a large and extremely ill-defined class of plaintiffs, creates corresponding liabilities in a broadly defined class of defendants, and leaves open many central questions the resolution of which, even if possible, would burden the federal courts for decades.[9]

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[7] *Lewis* v. *Transamerica Corp.*, No. 75-1285 (9th Cir., docketed 1975) (argued May 12, 1977).

[8] The district courts have divided on the issue: *Sullivan* v. *Chase Investment Services of Boston*, 434 F.Supp. 171 (N.D.Cal. 1977) (cause of action implied after dismissal of 10b-5 claim); *Angelakis* v. *Churchill Management Corp.*, [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,285 (N.D.Cal. 1975) (cause of action implied); *Lewis* v. *Transamerica Corp.*, No. C 73-2180 (N.D.Cal. 1974) ("no Federal jurisdiction" and no right of action; oral decision by District Court, *see* transcript of argument held Sept. 27, 1974 at 10), *appeal argued*, No. 75-1285 (9th Cir., May 12, 1977); *Bolger* v. *Laventhol, Krekstein, Horwath & Horwath*, 381 F.Supp. 260 (S.D. N.Y. 1974) (cause of action implied); *Greenspan* v. *del Toro*, [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,488 (S.D. Fla.) (no right of action), *appeal dismissed for want of prosecution*, No. 74-2943 (5th Cir. 1974); *Gammage* v. *Roberts, Scott & Co.*, [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,760 (S.D.Cal. 1974) (no right of action).

[9] In addition to the lack of a "purchase or sale" limitation in actions under § 206, and the overbroad construction of the defendant class, the majority's decision forbodes other areas of difficulty:

(footnote continued on following page)

The result is, as the dissent below noted, "a claim for relief without limitation" (A44). This new claim is indeed broader than any other right of action, express or implied, under the federal securities laws. With or without judicial definition, it will necessarily result in an "inexorable broadening of the class of plaintiffs who may sue." *Blue Chip Stamps, supra* at 747-48. The full measure of this extension of federal jurisdiction into an area of law traditionally governed by state partnership and contract law cannot now be known, but, according to the SEC, even this case—in which respondents received a huge profit on their investment and allege no fraud in connection with the purchase or sale of a security—"is not one that would test the outer limits of the cause of action created by the antifraud provisions of the federal securities laws" (SEC Br. 30 n.34). The apparent expectation of the SEC is that this right of action, like the right of action under Rule 10b-5 so aptly

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(footnote continued from preceding page)

Virtually Boundless Plaintiff Class. Section 206 applies not only to clients of investment advisers but also to "prospective clients," an undefined and as yet unconstrued term. Moreover, by excising from its opinion the statement that the general partners were investment advisers "to the limited partners" (A51, *modifying* A19 n.16), the majority appears to hold (i) that the partnership, not the limited partners thereof, was the "client," and (ii) that the class of plaintiffs extends to non-client individuals with some interest in an advised "client" who sue, not derivatively, but in their own right.

Overbroad Construction of Advisers' Duty. Although § 206 imposes a duty on investment advisers to refrain from "fraudulent, deceptive or manipulative" conduct, the majority below has created a right of action under § 206 in which *nondisclosure* is the gravamen of the complaint.

Recovery for Negligent Misstatement. Likewise, claimants under § 206 may not be required to prove scienter; Rule 206(4)-1(a)(5), 17 C.F.R. § 275.206(4)-1(a)(5), appears to define any "untrue statement" in any "advertisement" (a broadly defined term, *see* Rule 206(4)-1(b)) to be, whether or not intentional, a "fraudulent, deceptive, or manipulative act, practice or course of business . . . ."

described by this Court, may someday become "a judicial oak which has grown from little more than a legislative acorn." *Blue Chip Stamps, supra* at 737.

II

"The starting point in every case involving construction of a statute is the language itself." *Blue Chip Stamps, supra* at 756 (Powell, J., concurring). In the case of the Advisers Act, the unmistakably distinctive language of the jurisdictional section, § 214, especially when read against the background of the Act's legislative history, demonstrates a clear Congressional intent to deny implied actions for damages under the Act. *See generally Cort* v. *Ash,* 422 U.S. 66, 78 (1975).

Section 214 of the bill finally enacted by Congress in 1940, unlike the earlier drafts submitted by the SEC and others, and unlike *every* other federal securities act,[10] does not confer jurisdiction on the district courts to hear "actions at law brought to enforce any liability or duty created by" the Act. The district courts are granted only jurisdiction to hear criminal prosecutions and "suits in equity to enjoin any violation of this subchapter." The deliberate omission of the words "actions at law" and the use of the word "violation" rather than "liability" can only be construed as limiting the jurisdiction of the federal courts under § 206 to criminal prosecutions and SEC enforcement proceedings.

Since 1940, Congress has foregone at least three opportunities to include a provision for civil liability. As recently

[10] Securities Act of 1933, Section 22, 15 U.S.C. § 77v; Securities Exchange Act of 1934, Section 27, 15 U.S.C. § 78aa; Public Utility Holding Company Act of 1935, Section 25, U.S.C. § 79y; Trust Indenture Act of 1939, Section 322, 15 U.S.C. § 77vvv; and Investment Company Act of 1940, Section 44, 15 U.S.C. § 80a-43.

as 1975, Congress declined to act on a recommendation by the SEC that it reinsert the "actions at law" language deleted from the early drafts in 1940. Congressional intent has rarely been clearer.

A. 1940

The legislative record demonstrates Congress' recognition that in 1940 it knew very little about the "investment counsel" profession, even after a brief study by the SEC and Congress.[11] The "basic approach" of the Act was, in the words of the chief counsel to the SEC study, a "compulsory census" designed only to reveal the identity, number and general activities of those who receive compensation for advising others concerning securities transactions.[12] The

[11] The majority below refers to "exhaustive studies" and "extensive reports" (A15) by the SEC that preceded enactment of the Investment Company Act and Investment Advisers Act, which were passed as Titles I and II of the same bill, but fails to note that only 70 of 5,335 pages of SEC reports, and only 72 of 1,276 pages of testimony before Congressional committees concerned Title II, the Advisers Act. (Compilation of reports appears at *Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 76th Cong., 3d Sess. (1940) [hereinafter *"Senate Hearings"*] at 307; Advisers Act testimony appears at *Investment Trusts and Investment Companies: Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce,* 76th Cong., 3d Sess. (1940) [hereinafter *"House Hearings"*] at 86-93, and *Senate Hearings* at 47-51, 318-21, 711-64, 1124)

[12] David Schenker, chief counsel to the SEC's study of investment trusts and investment companies, testified in the Senate hearings:

> "Therefore, our fundamental approach to this problem is in the first instance, before we could intelligently make an appraisal of the economic function or of the abuses which might exist in that type of organization, to see if we could not get something which approximated *a compulsory census. Fundamentally that is the basic approach of title 2* [the Advisers Act]. We first would like to find out how many people are engaged in this business, what their connections are, what is the extent of their authority, what is their background, who they are, and how they handle the people's funds?" *Senate Hearings* at 48 (emphasis added).

SEC was given customary enforcement powers, and a general antifraud provision, § 206, was included, but in contrast to every other federal securities statute the Advisers Act was enacted without any provision for civil liability.

The original draft bill would have conferred district court jurisdiction over "actions at law"; early drafts and committee prints incorporated by reference the jurisdictional section (§ 25) of the Public Utility Holding Company Act of 1935, which includes the "actions at law" language.[13] However, the industry voiced strong opposition to the early drafts and, after a three-week hiatus in the hearings during which SEC and industry representatives met and negotiated, the industry submitted a draft of its own. That draft,[14] which was accepted by the SEC and enacted by Congress,[15] for

[13] *See, e.g.*, S. 3580, 76th Cong., 3d Sess 98 (introduced by Sen. Wagner on March 14, 1940); H.R. 8935, 76th Cong., 3d Sess. 98 (introduced by Cong. Lea on March 14, 1940).

[14] The industry draft was incorporated into a committee print: Staff of Senate Comm. on Banking and Currency, 76th Cong., 3d Sess., S. 3580 at 135-36 (Comm. Print, May 24, 1940).

[15] Although the industry had cooperated with the SEC throughout the SEC study (*Senate Hearings* at 41), there was no agreement on the first draft bill submitted by the SEC to Congress (*id.* at 41-42, 175, 345); there was, in fact, vehement industry opposition (*House Hearings* at 88-90, 92; *Senate Hearings* at 712-23, 737-54). During a three-week period (86 Cong. Rec. 10069 (remarks of Senator Wagner)) following the April hearings, representatives of industry negotiated changes in the proposed bill (*House Hearings* at 88-90, 92; S. Rep. No. 1775, 76th Cong., 3d Sess. 21 (1940).

Finally, it was the industry draft of Title II, the Advisers Act, that Congress enacted. The chief counsel to the SEC study testified at the conclusion of the Senate Hearings:

> "In connection with the investment advisers, I think that Robert Page who represented Scudder, Stevens & Clark . . . submitted a draft of the bill to us, which is the draft that is included in this new bill." *Senate Hearings* at 1124.

See D. Rogers, A Brief History of the Investment Counsel Association (April 1975) (unpublished draft at Investment Counsel Association, 127 East 59th Street, New York, New York).

the first time omitted the critical language conferring on the district courts jurisdiction to hear "actions at law brought to enforce any liability or duty created by" the Act.

B. 1960

After consideration of "[e]xtensive proposals" submitted by the SEC in 1960,[16] Congress amended the Advisers Act, but only to strengthen the Commission's enforcement powers. No change was proposed or effected in § 214.[17]

C. 1970

Again in 1970, while amending the Advisers Act and while adding to the Investment Company Act a strictly limited, express right of action against investment advisers to mutual funds (§ 36(b)), Congress refrained from adding a right of action under the Advisers Act against other investment advisers generally.

D. 1975

Finally, in 1975, just three weeks after the Court of Appeals requested the parties to this case, and the SEC as

[16] S. Rep. No. 1760, 86th Cong., 2d Sess. 2 (1960). The amendments to the Advisers Act effected 19 changes in 11 of the Act's 21 sections.

The Senate report emphasized once again the extremely limited scope of the Advisers Act:

> "The Investment Advisers Act of 1940 was passed as title II of the bill of which title I was the Investment Company Act. Unlike other Federal securities statutes, it has few substantive or regulatory provisions. Modeled somewhat on the broker-dealer registration provisions of the Securities Exchange Act of 1934, it resembles a continuing census of the Nation's investment advisers." S. Rep. No. 1760, 86th Cong., 2d Sess. 2 (1960).

[17] Even though the question of jurisdiction had been raised in 1957 in an action in which the SEC had filed an *amicus* brief supporting recognition of private actions. *Hull* v. *Newman, Kennedy & Co.*, No. 118-283 (S.D.N.Y. 1957) (settled); *see* 24 SEC Ann. Rep. 162 (1958).

amicus, to file briefs on the Advisers Act questions raised in this action (A75-78), the SEC proposed to Congress that it reinsert the very words, "actions at law brought to enforce any liability or duty created by", that were deleted from early drafts of the bill in 1940. Investment Advisers Act Release No. 491 (December 15, 1975), [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,341. Although hearings were held on the SEC's proposals, and testimony was received on the proposed amendment to § 214,[18] Congress failed to act on the proposals. The proposals have not been resubmitted by the SEC.

* * *

The majority below attempted to explain the deletion from § 214 as follows:

> "Appellees argue that the omission of any reference to 'actions at law' in Section 214 manifests a legislative intent to preclude private rights of action under the Advisers Act. We disagree. In our view, the reason for this omission is that each of the other Acts whose jurisdictional provisions refer to 'actions at law' contains one or more sections *expressly* granting injured parties a private right of action for damages. There is no provision in the Advisers Act

[18] *Investment Advisers Act Amendments: Hearings on S. 2849 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs,* 94th Cong., 2d Sess. (1976); *Investment Advisers Act Amendments: Hearings on H.R. 13737 Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce,* 94th Cong., 2d Sess. (1976).

In his testimony before the Senate committee, Mr. John I. Casey, chairman of the Investment Counsel Association, objected to the enactment of a private right of action without limits similar to those in § 36(b) of the Investment Company Act of 1940. Mr. Casey submitted to the Senate committee certain legislative history materials showing the deletion of the "actions at law" language from early drafts of the bill in 1940.

> which *expressly* provides for private actions; since it is a less complex statute, containing no express grants of right of action to private parties, a reference to 'actions at law' would be superfluous." (A25) (footnote omitted)

With all due respect to the majority below, that is no explanation. The intentional omission of express rights of action and of a jurisdictional grant for actions at law is no basis for implying both such provisions in the statute.

III

The holding of the Court of Appeals that an action for money damages should be implied is directly contrary to this Court's instruction in *National Railroad Passenger Corp.* v. *National Ass'n of Railroad Passengers,* 414 U.S. 453, 458 (1974) that " '[w]hen a statute limits a thing to be done in a particular mode, it includes the negative of any other mode,' " *quoting Botany Mills* v. *United States,* 278 U.S. 282, 289 (1929). When Congress limited relief under the Advisers Act to equitable relief, "it include[d] the negative of any other mode", monetary liability. This rule of statutory construction should yield only "to clear contrary evidence of legislative intent." 414 U.S. at 458. In the case of the Advisers Act, no contrary legislative intent whatever is found, either in 1940 or in the 38 succeeding years.

Compounding the majority's error in misreading legislative history[19] is its failure to heed the recent decisions

[19] The panel below employed the same method of legislative history analysis it had adopted in *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.,* 480 F.2d 341 (2d Cir. 1973), *rev'd, Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1 (1977).

(footnote continued on following page)

of this Court that counsel caution and restraint in the creation and application of implied rights of action. *See Blue Chip Stamps, supra* (reaffirms "purchase or sale" requirement to prevent the "danger of vexatious litigation which could result from a widely expanded class of plaintiffs under Rule 10b-5"); *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976) (dismisses Rule 10b-5 claim alleging negligent failure to discover and disclose in light of legislative history indicating requirement of some element of scienter); *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462 (1977) (refuses to "federalize" state corporation law that deals with transactions in securities to serve "what is 'at best a subsidiary purpose' of the federal legislations"); *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1 (1977) (analysis of the *four* factors enunciated in *Cort* v. *Ash* leads to conclusion that private right of action under § 14(e) of 1934 Act not necessary to effectuate Congress' goals); *Securities Investor Protection Corp.* v. *Barbour,* 421 U.S. 412 (1975) (express statutory provision for one form of proceeding "ordinarily implied that no other means of enforcement was intended by the Legislature"). Although the majority cites *Cort* v. *Ash* in passing, it totally

(footnote continued from preceding page)

In *Chris-Craft,* it wrote:

> "We will not infer from the silence of the statute that Congress intended to deny a federal remedy . . . ." 480 F.2d at 360-61.

Two days after this Court issued its opinion in *Chris-Craft* reversing the Court of Appeals, the same panel, this time with Judge Gurfein in dissent, wrote in this action:

> "We hesitate to reach such a result [failure to recognize a right of action] absent clear evidence from the Act's legislative history that private actions were not intended." (A23)

omits any point-by-point discussion of its four criteria,[20] as Judge Gurfein points out in dissent (A39-40).

As this Court stated recently in *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. at 26, the courts "must be wary against interpolating [their] notions of policy in the interstices of legislative provisions," quoting *Scripps-Howard Radio* v. *FCC,* 316 U.S. 4, 11 (1942).

[20] *Cort* v. *Ash,* 422 U.S. 66, 78 (1975), cites four specific factors "relevant" to the determination "whether a private remedy is implicit in a statute not expressly providing one":

"First, is the plaintiff 'one of the class for whose especial *benefit the statute was enacted'?"* While the clients of investment advisers were intended to be protected by the Act, the legislative history, *see* Point II, *supra,* also demonstrates that the Act was drafted to protect the advisers themselves from the abuses of unbridled regulatory power. *See, e.g.,* H.R. REP. No. 2639, 76th Cong., 3d Sess. 28, 30 (1940).

"Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one?" The discussion in Point II and Judge Gurfein's dissent show that "there *is* implicit legislative intent to deny such a remedy" (A40).

"Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff?" As Judge Gurfein stated

> "Analytically, it would be equally proper to say that implication of a private action under the Advisers Act is not 'consistent with the underlying purposes of the legislative scheme.' *Cort, supra,* at 78. For though such a remedy may be consistent with the goal of protecting customers of investment advisers, it is hardly consistent with the desire not to subject advisers to monetary liability, at least, until further study by Congress." (A40 n.9)

Fourth, "is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?" There is of course nothing uniquely federal about an action based in fraud, such as an action under § 206 would be.

IV

Persons who, like the petitioner general partners, manage private and family investments in the partnership form involving a substantial portion of their personal assets have never been considered to be engaged in the "business of advising others" so as to render them "investment advisers" subject to the Advisers Act.[21] Under partnership law, general partners of a limited partnership are vested with full title to the partnership estate, assume the risks of all liabilities of the partnership and are legally charged with the management of the partnership assets. As to the management of the partnership estate, the general partners cannot

[21] Early rulings of the full Commission and subsequent judicial decisions citing those rulings have firmly established the rule. *See, e.g.:*

In the Matter of Roosevelt & Son, Investment Advisers Release No. 54 (September 2, 1949), 29 S.E.C. 879, [1948-1952 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 76,016 (general partners of non-public, predominantly family investment advice vehicle, who had own assets under management and who would serve as trustees of advised trusts not advisers under the Act);

In the Matter of the Pitcairn Company, Investment Advisers Act Release No. 52 (March 7, 1949), 29 S.E.C. 186, [1948-1952 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 75,990 (private, family investment manager that never solicited public "clients" not adviser under the Act);

In the Matter of Loring, Investment Advisers Act Release No. 33 (July 22, 1942), 11 S.E.C. 885, [1941-1944 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 75,299 (trustee "holds legal title to the property and acts as principal"; compensated trustee not investment adviser under the Act);

In the Matter of Donner Estates, Inc., Investment Advisers Act Release No. 21 (November 3, 1941), 10 S.E.C. 400, [1941-1944 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 75,216 (private, predominantly family investment vehicle; corporation, which was owned by and advised separate trusts established for family and non-family trusts, not adviser under the Act);

Selzer v. *Bank of Bermuda Ltd.,* 385 F. Supp. 415, 420 (S.D.N.Y. 1974) (a "trustee acts himself as principal," he "does not advise the trust corpus, which then takes action pursuant to his advice"; compensated trustee not investment adviser under the Act, citing *Loring, supra*).

as a matter of law be construed as being "in the business of advising others".

Under the rationale of the majority opinion below, not only general partners of investment partnerships but *every* compensated trustee, executor and other fiduciary with discretionary investment powers would be deemed an "investment adviser." Such a momentous result would be worked in the complete absence of any evidence of congressional intent to regulate with so broad a sweep, and in derogation of the SEC's own rulings, which have consistently interpreted "investment adviser" to exclude persons, like FBA's general partners, who do not solicit funds of the public, do not hold themselves out to the general public as offering investment advice, and limit their activities to managing private investment entities for themselves, their families and friends.

V

The measure of damages fashioned by the Court of Appeals conflicts with the basic rule of damages under the federal securities laws.[22]

[22] *See, e.g., Harris* v. *American Investment Company,* 523 F.2d 220 (8th Cir. 1975), *cert. denied,* 423 U.S. 1054 (1976); *Wolf* v. *Frank,* 477 F.2d 467 (5th Cir.), *cert. denied,* 414 U.S. 975 (1973); *Levine* v. *Seilon,* 439 F.2d 328 (2d Cir. 1971); *Janigan* v. *Taylor,* 344 F.2d 781 (1st Cir.), *cert. denied,* 382 U.S. 879 (1965); *Kohler* v. *Kohler Co.,* 208 F.Supp. 808 (E.D. Wisc. 1962), *aff'd,* 319 F.2d 634 (7th Cir. 1963); *Estate Counseling Service, Inc.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 303 F.2d 527, 533 (10th Cir. 1962). Even those courts which have held that a private right of action for damages exists under Section 206 of the Advisers Act have never implied that the measure of damages under that section would be different from the measure of damages applicable in other antifraud provisions of the federal securities laws. *See* discussion of Judge Carter in *Abrahamson* v. *Fleschner* (A65-74). *See also Courtland* v. *Walston & Co., Inc.,* 340 F.Supp. 1076, 1093 (S.D.N.Y. 1972).

The measure of damages adopted by the Court of Appeals in this case will permit plaintiffs to select or "fractionate" their investments, i.e., to isolate securities on which profits are reaped from those on which there are losses, in calculating damages—a procedure which another panel of the same Court of Appeals expressly condemned. *Byrnes* v. *Faulkner, Dawkins & Sullivan,* 550 F.2d 1303 (2d Cir. 1977).[23] Courts in other circuits hold that any losses suffered by a plaintiff on an investment must be offset by any gains realized. *Esplin* v. *Hirschi,* 402 F.2d 94, 105 (10th Cir, 1968), *cert. denied,* 394 U.S. 928 (1969); *Schaefer* v. *First National Bank,* 326 F.Supp. 1186 (N.D. Ill. 1970), *appeal dismissed,* 465 F.2d 234 (7th Cir. 1972); *Richardson* v. *MacArthur,* 451 F.2d 35, 44 (10th Cir. 1971); *Garnatz* v. *Stifel, Nicolaus & Co.,* 559 F.2d 1357 (8th Cir. 1977). If the result is a net profit, a claimant should have no actionable claim for damages under the federal securities laws. *Wolf* v. *Frank,* 477 F.2d (5th Cir.), *cert. denied,* 414 U.S. 975 (1973); *Levine* v. *Seilon,* 439 F.2d 328, 334-35 (2d Cir. 1971); *Ferschtman* v. *Schectman,* 450 F.2d 1357, 1361 (2d Cir. 1971).

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[23] The irreconcilable conflict which exists between the decision of the Court of Appeals in the *Abrahamson* case and the decisions of other courts involving the measure of damages under the antifraud provisions of the federal securities laws is best illustrated by a comparison of the decisions of the Second Circuit in *Abrahamson* and *Byrnes, supra. Abrahamson* was decided on February 25, 1977, *Byrnes,* on March 1, 1977. In *Byrnes,* the Court of Appeals, citing the District Court's opinion in this case, *denied* a claim for damages under the federal securities laws where the claimant attempted to isolate prospective losses from prospective gains:

> "Thus, far from suffering a proximate loss from the acts of appellants, *see Herpich* v. *Wallace,* 430 F.2d 792, 810 (5th Cir. 1970), Faulkner was benefitted overall by them. For damages purposes under the Exchange Act, the transaction cannot be fractionated, since otherwise 'actual damages on account of the act complained of' would be exceeded. See *Abrahamson* v. *Fleschner,* 392 F.Supp. 740, 746-47 (S.D.N.Y. 1975)." 550 F.2d at 1314.

The novel measure of damages fashioned by the Court of Appeals here can only assure a flood of claims under the Advisers Act by claimants who, as respondents do here, allege in hindsight that they "would have" made more money had they withdrawn at the height of the market.

CONCLUSION

For the foregoing reasons, a writ of certiorari should issue to the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

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March 14, 1978

APPENDIX

Text of Statutes Involved

Section 206 of the Investment Advisers Act of 1940, 54 Stat. 852, as amended, 74 Stat. 887, 15 U.S.C. § 80b-6, provides:

PROHIBITED TRANSACTIONS BY REGISTERED INVESTMENT ADVISERS

SEC. 206. It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph (3) shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction;

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

Text of Statutes Involved

Section 214 of the Investment Advisers Act of 1940, 54 Stat. 856, 15 U.S.C. § 80b-14, provides:

Jurisdiction of Offenses and Suits

Sec. 214. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enjoin any violation of this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against the Commission in any court.

UNITED STATES COURT OF APPEALS

For the Second Circuit

No. 212—September Term, 1975.

(Submitted February 28, 1976*
Decided February 25, 1977.)

Docket No. 75-7203

Robert Abrahamson and Marjorie Abrahamson,

Plaintiffs-Appellants,

v.

Malcolm K. Fleschner, William J. Becker, Harold B. Ehrlich, Leon Pomerance, Fleschner Becker Associates, and Harry Goodkin & Company,

Defendants-Appellees.

Before:

Mansfield, Timbers and Gurfein,

Circuit Judges.

Appeal from judgment entered in the Southern District of New York, Robert L. Carter, *District Judge*, 392 F. Supp. 740, dismissing complaint, on cross-motions for summary judgment, in action to recover damages for alleged violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder; and of

* See our interim opinion in this case. *Abrahamson* v. *Fleschner*, 537 F.2d 27 (2 Cir. 1975).

Section 206 of the Investment Advisers Act of 1940 and Rule 206(4)-1 promulgated thereunder.

Affirmed as to dismissal of the Securities Act claim; as to dismissal of the Investment Advisers Act claim, reversed and remanded for trial.

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Timbers, *Circuit Judge:*

Of the several questions presented under the antifraud provisions of the federal securities laws, those under the Investment Advisers Act of 1940 appear to be of first impression at the appellate level.

The appeal is from a judgment entered in the Southern District of New York, Robert L. Carter, *District Judge,* 392 F.Supp. 740, dismissing the complaint, on cross-motions for summary judgment, in an action to recover damages for alleged violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b)(1970), and of Rule 10b-5 thereunder, 17 C.F.R. §240.10b-5 (1976); and alleged violations of Section 206 of the Investment Advisers Act of 1940, 15 U.S.C. §80b-6 (1970), and of Rule 206(4)-1 thereunder, 17 C.F.R. §275.206(4) (1976).

The essential questions presented and our rulings thereon are as follows:

(1) Whether the complaint states a claim upon which relief can be granted under Section 10(b) of the 1934 Act and Rule 10b-5.

We hold it does not.

(2) Whether defendants who are general partners of the investment partnership are investment advisers within the meaning of Section 202(a)(11) of the Advisers Act.

We hold they are.

(3) Whether there is an implied private right of action for damages under the Advisers Act.

We hold there is.

(4) Whether the complaint alleges compensable damages under the Advisers Act.

We hold it does.

(5) Whether the complaint states a claim upon which relief can be granted under Section 206 of the Advisers Act and Rule 206(4)-1.

We hold it does.

We affirm the dismissal of the Exchange Act claim; but as to the dismissal of the Advisers Act claim, we reverse and remand for trial.

I. Facts

The following summary of the essential facts is believed necessary to an understanding of our rulings on the questions presented.[1] The facts are not in dispute.

Plaintiffs Robert Abrahamson and Marjorie Abrahamson, husband and wife, were limited partners of defendant Fleschner Becker Associates (FBA), an investment partnership, from its inception on July 1, 1965 until they withdrew on September 30, 1970.

Defendants Malcolm K. Fleschner (Fleschner) and William J. Becker (Becker) are general partners of FBA. Fleschner was its founder and has been a general partner since its inception. Becker became a general partner on April 1, 1966. Defendant Harold B. Ehrlich (Ehrlich) was a general partner from October 1, 1968 through September 30, 1969. Defendant Harry Goodkin & Company (Goodkin) is a firm of certified public accountants which audited FBA's books and certified FBA's financial reports for the fiscal years 1966, 1967 and 1968.

In late 1964 and in 1965 plaintiffs had several conversations with Fleschner who expressed his intention of forming an investment partnership. He told plaintiffs that the partnership would have a conservative investment policy.

1 We assume familiarity with our prior opinion in this case, 537 F.2d 27, and that of the district court, 392 F.Supp. 740.

Plaintiffs expressed their concern for financial security and conservatism in their investments.

By a partnership agreement dated July 1, 1965, FBA began as a small partnership. The original partners consisted of one general partner (Fleschner) and eight limited partners (plaintiffs, four members of Fleschner's family and two others). Plaintiffs' initial contribution was $150,000.

FBA grew rapidly. By April 1, 1966 it had two general partners and thirty-five limited partners; and by October 1, 1968 it had three general partners and sixty-six limited partners. Each partner had an account which represented the appreciated value of his contributions to the pooled funds, less withdrawals and certain fees. By October 1, 1968 FBA's assets were approximately $60 million.

For managing the partnership investments, the general partners received substantial fees. They were paid 20% of FBA's net profits and net capital gains for each fiscal year. In addition, the partnership agreement of October 1, 1968 provided for an annual salary of $25,000 for each general partner who managed the partnership's investments.

The limited partners did not participate in managing the partnership's investments. A limited partner could withdraw all or part of the balance in his capital account at the end of any fiscal year (September 30), provided that he gave the required advance notice. Prior to October 1, 1968, 30 days notice was required; thereafter, 60 days notice was required. There were similar notice requirements for withdrawal from membership in the partnership.

With the increase in the number of limited partners and the concomitant increase in the size of the firm's assets, certain changes were made in the structure of the partnership. The original July 1, 1965 partnership agreement was superseded by a new agreement dated April 1, 1966 which in turn was superseded by the October 1, 1968 agreement.

The principal change effected by the 1966 agreement was the addition of Becker as a general and managing partner and the inclusion of additional limited partners. The 1968 agreement, in addition to authorizing salaries of $25,000 per year for those general partners who managed the partnership's investments, included Ehrlich as a general partner; added a large number of limited partners; expanded and detailed the stated purposes of the partnership; and made a number of other changes referred to below.

During the period plaintiffs were limited partners of FBA the general partners mailed monthly reports to all of the firm's limited partners. These reports were concise, two paragraph statements which set forth the percentage increase or decrease in the value of the firm's investments for the year to date and compared this performance with Standard & Poors 500 Stock Average.

The reports also included statements of the firm's investment policy. Between November 1967 and April 1968 the reports repeatedly represented that FBA was maintaining a "low risk stance" and "a most conservative posture." [2]

In addition to the monthly reports, during 1967 and 1968 Goodkin mailed to the limited partners certified year end financial reports. These financial reports included balance sheets which showed the total of FBA's investments in securities. The balance sheets of September 30, 1967 and September 30, 1968 did not disclose that the firm was investing in unregistered securities.[3] Investments in such securities were included in the aggregate of all portfolio investments. The value of FBA's total investments in se-

2 For examples of these representations in the monthly reports, see the district court opinion, 392 F.Supp. at 742 n. 2.

3 Unregistered securities are securities which are not registered with the Securities and Exchange Commission. They have only a limited market and are subject to restrictions as to further sale.

curities was denominated as the "market value" of the securities.

Despite the representations in the monthly reports that FBA's investments were most conservative and of low risk, between September 1967 and September 1968 the firm increased its investments in unregistered securities from approximately 15% to approximately 72% of its portfolio. Between September 1968 and September 1969 the firm's investments in unregistered securities fluctuated from about 72% to 88% of its portfolio.[4] During this latter period the monthly reports continued not to disclose the firm's sizable investments in unregistered securities.

In either December 1969 or January 1970 plaintiffs received the financial report for the fiscal year ending September 30, 1969. This report was not prepared by Goodkin, but by another accounting firm. A footnote to this report disclosed that approximately 77% ($30,411,868) of FBA's total investments in securities ($39,355,310) consisted of unregistered securities. The firm's total assets as of September 30, 1969 were $51,747,995.

Plaintiffs first learned of FBA's substantial investments in unregistered securities from the September 30, 1969 report. Having received this report in December 1969 or January 1970, it was too late for them to withdraw from the firm, in accordance with the partnership agreement, at the end of the fiscal year which ended September 30, 1969. Plaintiffs did withdraw at the end of the following fiscal year, on September 30, 1970. This was the earliest they could withdraw their investments or as partners under the terms of the partnership agreement.

4 In their complaint in the instant action, plaintiffs alleged that during the period they were limited partners the firm made between 40 and 80 separate purchases of unregistered securities, including the securities of more than 40 different issuers. They alleged that most of these purchases took place after 1967.

During the five year period they were limited partners, both plaintiffs received substantial net profits.[5] Robert Abrahamson realized a net profit of $156,097; Marjorie Abrahamson a net profit of $133,081.35.

Both plaintiffs claim that as of late 1968 their investments were worth considerably more than indicated by the firm's financial reports, and that the firm incurred substantial losses on its investments in unregistered securities. Without apportioning between losses sustained from investments in unregistered securities and other losses,[6] Robert Abrahamson claims that between September 30, 1968 and the date of his withdrawal his capital account sustained losses totalling $454,979. Marjorie Abrahamson claims total losses of $799,821 during this period.

Plaintiffs commenced the instant action in the Southern District of New York on January 25, 1971. Jurisdiction was invoked under Section 37 of the Exchange Act, 15 U.S.C. §78aa (1970), and Section 214 of the Advisers Act, 15 U.S.C. §80b-14 (1970). The complaint embodies the claims stated above and summarized in our prior opinion. 537 F.2d 27.

Both sides having moved for summary judgment, Judge Carter on March 4, 1975 filed an opinion, 392 F.Supp. 740, granting defendants' motions and denying plaintiffs' motion. Without reaching the merits of plaintiffs' claims under either the Exchange Act or the Advisers Act, the judge held that, since plaintiffs had realized a net profit

5 See the schedule set forth in the district court opinion, 392 F.Supp. at 743, showing plaintiffs' capital contributions, interim withdrawals, final distributive shares and net profits.

6 Plaintiffs claim that they are entitled to recover the difference between what they received when they withdrew from the partnership in 1970 and what they would have received had they withdrawn as of September 30, 1968. Accordingly they did not attempt an apportionment between losses attributable to excessive investments in unregistered securities and losses from unchallenged investments.

on their overall five-year investments in FBA, they had failed to prove damages compensable under the federal securities laws. From the judgment entered March 27, 1975 dismissing the complaint, the instant appeal has been taken.

II. Exchange Act Claim

We need not tarry with plaintiffs' claim under Section 10(b) of the 1934 Act and Rule 10b-5 for we find that each of the arguments urged by plaintiffs in support of that claim is without merit.

First, in an effort to meet the requirement of Section 10(b) and Rule 10b-5 that they must allege a fraud "in connection with the purchase or sale of any security,"[7] plaintiffs argue that their interest in FBA was a "security" and that the modifications of the partnership agreement in 1968 constituted an exchange of one security for another.[8] In support of this theory, plaintiffs rely on cases which have held that significant modifications in the rights of security holders may constitute a "sale" of one security and "purchase" of another under Section 10(b) and Rule 10b-5, *Ingenito* v. *Bermec Corp.*, 376 F.Supp. 1154, 1179-82 (S.D.N.Y. 1974); or a "sale" or "issue" of a security under the Public Utility Holding Company Act of 1935,

7 This is the familiar provision of both Section 10(b) and Rule 10b-5. Obviously, the fraud alleged by plaintiffs was not "in connection with" either their initial investment in the partnership on July 1, 1965 or their withdrawal from the firm on September 30, 1970.

8 The principal modifications relied on by plaintiffs in their effort to show that the September 30, 1968 partnership agreement fundamentally changed the nature of their investment were: expansion of the general partners' authority to invest in other businesses and to make loans; authorization of $25,000 per year salaries for managing partners; shortening of the notice requirement for year end withdrawals of capital; provision for automatic termination of the partnership after ten years; and authorization for amendment of the partnership agreement by a vote of one-half of the limited partnership interests and two-thirds of the general partnership interests, rather than by the Executive Committee of the general partners as before.

SEC v. *Associated Gas & Elec. Co.,* 24 F.Supp. 899 (S.D. N.Y.), *aff'd,* 99 F.2d 795 (2 Cir. 1938); or an "issue" of stock under the Interstate Commerce Act, *United States* v. *New York, New Haven & Hartford R. Co.,* 276 F.2d 525 (2 Cir. 1959), *cert. denied,* 362 U.S. 961 (1960). We do not believe that this line of cases supports plaintiffs' claim in the instant case. Before changes in the rights of a security holder can qualify as the "purchase" of a new security under Section 10(b) and Rule 10b-5, there must be such significant change in the nature of the investment or in the investment risks as to amount to a new investment. We hold that the modifications effected by the adoption of a new partnership agreement on September 30, 1968 did not constitute the "purchase" and "sale" of new securities.

Second, plaintiffs argue that they are entitled to recover under Section 10(b) and Rule 10b-5 because they were fraudulently induced not to sell their partnership interests. They say that they would have withdrawn from the firm in 1968 if defendants had not misrepresented the true nature of the firm's investments at that time. The short answer to this branch of plaintiffs' argument is that the requirement of fraud in connection with the purchase or sale of a security is not satisfied by an allegation that plaintiffs were induced fraudulently *not* to sell their securities. *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 737-38 (1975).

We affirm the dismissal of plaintiffs' Exchange Act claim.[9]

9 Our affirmance of the dismissal of the Exchange Act claim is on the ground that the complaint fails to state a claim upon which relief can be granted—not on the ground relied upon by the district court for dismissal, namely, that, since plaintiffs had realized a net profit on their overall limited partnership investment, they had failed to prove damages compensable under the federal securities laws. We shall discuss this ground of the district court decision under the Adivsers Act claim, Section III, *infra.*

III. Advisers Act Claim

We come next to what we consider to be the chief question presented on this appeal—whether the complaint states a claim upon which relief can be granted under Section 206 of the Investment Advisers Act of 1940 (the Act)[10] and Rule 206(4)-1 thereunder.[11]

10 Section 206 of the Investment Advisers Act of 1940, 15 U.S.C. §80b-6 (1970), in relevant part provides:

"It shall be unlawful for any investment adviser by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

* * *

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative."

11 Rule 206(4)-1, 17 C.F.R. §275.206(4)-1 (1976), in relevant part provides:

"(a) It shall constitute a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of section 206(4) of the Act, for any investment adviser, directly or indirectly, to publish, circulate or distribute any advertisement:

* * *

(5) Which contains any untrue statement of a material fact, or which is otherwise false or misleading.

(b) For the purposes of this section the term 'advertisement' shall include any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (2) any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities."

The subordinate questions which we must consider in connection with this claim are (1) whether any of the defendant general partners are "investment advisers" within the meaning of Section 202(a)(11) of the Act;[12] (2) whether there is an implied private right of action for damages under the Act; and (3) whether plaintiffs have alleged compensable damages under the Act.

For the reasons below, we answer each of these questions in the affirmative. Accordingly, we reverse the dismissal of the Advisers Act claim and remand the case for trial on that claim.[13]

(1) *"Investment Advisers" Under Section 202(a)(11)*

Turning first to the threshold question whether any of the general partner defendants are "investment advisers" within the meaning of Section 202(a)(11), we hold that they are.

It is clear from the record that the general partners received substantial compensation for managing the limited partners' investments. Each of the three partnership agreements in effect between 1965 and 1970 provided that the general partners would be paid for their services 20% of the firm's net profits and net capital gains for each fiscal year. In addition, the partnership agreement of

12 Section 202(a)(11) of the Investment Advisers Act, 15 U.S.C. §80b-2 (a)(11) (1970), in relevant part provides:

> "'Investment adviser' means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities. . . ."

13 It was the Advisers Act claim to which we invited the parties and the SEC as amicus curiae to address their supplemental briefs when we filed our interim opinion following oral argument of this appeal. 537 F.2d at 28. We express our appreciation for the helpful briefs from counsel for all parties and the SEC in response to our invitation.

October 1, 1968 authorized an annual salary of $25,000 for each general partner who managed investments.

Since the general partners received compensation for their investment services, the only remaining inquiry under the statute is whether they were "engage[d] in the business of advising others" with respect to investments. On two independent grounds, we believe they were.

First, the monthly reports which contained the alleged fraudulent representations were reports which provided investment advice to the limited partners. The general partners' compensation depended in part upon the firm's net profits and capital gains. These in turn were affected by the size of the total funds under their control. The monthly reports were an integral part of the general partners' business of managing the limited partners' funds. In deciding whether or not to withdraw their funds from the pool, the limited partners necessarily relied heavily on the reports they received from the general partners.

Second, wholly aside from the monthly reports, we believe that the general partners as persons who managed the funds of others for compensation are "investment advisers" within the meaning of the statute. This is borne out by the plain language of Section 202(a)(11) and its related provisions, by evidence of legislative intent and by the broad remedial purposes of the Act.

The Investment Companies Act of 1940 and the companion Investment Advisers Act (Title II of the same enactment) were among statutes designed to eliminate certain abuses in the securities industry which were found to have contributed to the stock market crash of 1929 and the depression of the 1930s. *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963). The 1940 legislation was based upon exhaustive studies by the SEC which culminated in a number of extensive reports on investment trusts, investment companies and investment advis-

ers. The Investment Companies Act and the Advisers Act were intended to cover important areas of the securities industry which had not been covered by the earlier statutes. The Investment Companies Act is concerned with investment companies and other persons, including certain investment advisers, who deal with investment companies. The Advisers Act covers *all* investment advisers.

As stated in Section 201 of the Advisers Act, 15 U.S.C. §80b-1 (1970), that Act was based upon the findings and recommendations set forth in an SEC Report on investment counsel and advisory services. Securities and Exchange Commission, Investment Counsel, Investment Management, Investment Supervisory and Investment Advisory Services, H.R. Doc. No. 477, 76th Cong., 2d Sess., 1 (1939) (hereinafter "SEC Report"). The SEC Report referred to two types of investment advisers: (1) those with management powers over their clients' funds and the power to make purchases and sales for their clients ("discretionary"), and (2) those who merely made recommendations to their clients ("advisory"). SEC Report at 13. It noted the conspicuous need for regulation of individuals "who may solicit the funds of the public to be *controlled, managed,* and supervised . . . ." SEC Report at 28 (emphasis added). The report made it clear that its findings and recommendations were intended to cover persons who made purchases and sales of securities with their clients' funds.

The House and Senate Committee reports also make clear the intent of Congress. The Report of the Senate Committee on Banking and Currency which accompanied the bill to the Senate floor stated:

> "The report of the Commission to the Congress and the record before the committee is clear that the solution of the problems and abuses of investment advisory services—*individuals and companies which either handle pools of liquid funds of the public or give advice with respect to security transactions*—cannot be effected without Federal legislation.
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> • • •
>
> Virtually no limitations or restrictions exist with respect to the honesty and integrity of persons who may solicit funds to be *controlled, managed,* and *supervised.*" (emphasis added) S. Rep. No. 1775, 76th Cong., 3d Sess., 21 (1940).[14]

Similarly, the House Committee on Interstate and Foreign Commerce noted in its report the need to regulate firms which "managed, supervised, and gave investment advice" with respect to clients' funds. H.R. Rep. No. 2639, 76th Cong., 3d Sess., 27 (1940).[15]

In short, as for legislative intent, we believe that the SEC Report, together with the House and Senate Reports, make it clear that Congress intended to reach persons who receive compensation for investing funds of their clients.

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14 In its general statement on the background to the Advisers Act, the Senate Report stated:

> "Similarly, it is difficult definitely to estimate the amount of funds under the influence *or control* of investment advisers. However, some idea of the size of the funds administered by investment advisers may be deduced from the fact that 51 firms for which information was obtainable by the Commission *managed, supervised* and gave investment advice with respect to funds aggregating approximately $4,000,000,000." (emphasis added). S. Rep., *supra* at 21.

15 In 1960 and again in 1970, Congress considerably broadened the coverage of the Advisers Act. The Senate Report accompanying the bill which contained the 1960 amendments to the Act stated, with particular application here:

> "There are at present over 12½ million individuals in the United States who own corporate securities, nearly double those in 1952. It has been noted that this new group offers strong temptation to confidence men and swindlers who may give them biased advice or *misuse their funds or securities.*" (emphasis added). S. Rep. No. 1760, 86th Cong., 2d Sess. 4 (1960).

Moreover the plain language of Section 202(a)(11) and related provisions of the Act bear out this legislative intent. Section 202(a)(11) includes any person who "advises" others with respect to investments. Section 203(c)(1)(D), 15 U.S.C. §80b-3(c)(1)(D) (1970), requires the investment adviser to disclose the nature and scope of his "authority . . . with respect to clients' funds and accounts" in his registration statement. And Section 205, 15 U.S.C. §80b-5 (1970), establishes certain standards for investment advisers with respect to "investment advisory contracts" which include contracts "to act as an investment adviser or to manage any investment or trading account. . . ." These provisions reflect the fact that many investment advisers "advise" their customers by exercising control over what purchases and sales are made with their clients' funds.

We hold that the defendant general partners of FBA are investment advisers within the meaning of Section 202(a)(11) of the Act.[16]

16 Defendant Harry Goodkin & Company argues that, since it was not an "investment adviser", it cannot be held liable for aiding and abetting a fraud committed by those who were investment advisers. Goodkin points out that Section 206 applies only to an investment adviser and that Section 202(a)(11)(B) excludes from the definition of an investment adviser an accountant acting in the practice of his profession. We agree that the exemption excludes an accountant's usual activities from the scope of the Act and excludes the accountant from coverage under the registration provisions and many of the other regulatory provisions of the Act even if the accountant is employed by an investment adviser. But the exemption does not shield the accountant from liability under the antifraud provisions of the Act if the accountant aids and abets an investment adviser with *knowledge* that his conduct is assisting an investment adviser in defrauding a client. Cf. Section 209(e) of the Act, 15 U.S.C. §80b-9(e) (1970), which authorizes the SEC to seek injunctive relief and, if necessary, to recommend criminal proceedings against those who "aid, abet [or] counsel" violations of the Act. In view of the limitation of Section 206 to investment advisers, however, we believe that before Goodkin can be held liable as an aider and abetter, there must be a showing that Goodkin: (a) knew of the investment adviser-client relationship; (b) had knowledge of the fraud; and (c) acted in concert with the investment adviser. Cf. *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976).

Whether Goodkin is liable for aiding and abetting the investment advisers is one of the issues to be determined at trial pursuant to our remand.

As to whether FBA itself is a proper defendant with respect to the Advisers Act claim, for aught that appears in the record before us, we have serious doubts. The general partners as individuals, not FBA as an entity, were the investment advisers to the limited partners. If upon remand, and after a hearing, the district court finds no more than the record now discloses with respect to the liability of FBA itself under the Advisers Act claim, it should dismiss as against the firm.

(2) *Private Right of Action Under Section 206*

As with other provisions of the federal securities laws under which the courts have found implied private rights of action, Section 206 of the Advisers Act does not expressly authorize private actions. We therefore must decide whether a private right of action is to be implied under that section. For the reasons below, we hold that it is.[17]

17 The SEC has submitted to Congress a number of proposed amendments to the Advisers Act. One would provide explicitly for private actions under the Advisers Act. See Investment Advisers Act Release No. 491, 8 SEC Docket 744 (December 15, 1975). In announcing its proposal, the SEC repeated its view that the existing language was sufficient to imply a private right of action. Its proposal was intended to put to rest those few decisions which had found no implied right of action.

In the two district court cases in this Circuit in which the issue has been considered, the court has held that an implied right of action exists under the Advisers Act. *Jones* v. *Equitable Life Assurance Society*, 409 F.Supp. 370 (S.D.N.Y. 1975), *accord, Angelakis* v. *Churchill Management Corp.*, CCH Fed. Sec. L. Rep. ¶95,285 (N.D.Cal. 1975); *Bolger* v. *Laventhol, Krekstein, Horwath & Horwath*, 381 F.Supp. 260 (S.D.N.Y. 1975). *Contra, Gammage* v. *Roberts, Scott & Co.*, CCH Fed. Sec. L. Rep. ¶94,761 (S.D.Cal. 1974); *Greenspan* v. *Eugene Campos Del Toro*, 73-638-Civ. (S.D.Fla. May 17, 1974).

The commentators who have reviewed these decisions agree that a private right of action should be implied under the Advisers Act. Note, *Private Causes of Action Under Section 206 of the Investment Advisers*

The Supreme Court has recognized in a variety of contexts that private rights of action may be implied in favor of the intended beneficiaries of a statute where necessary to implement the statute's underlying purposes. *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n. 9 (1971); *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964); *Tunstall* v. *Brotherhood of Locomotive Firemen and Enginemen*, 323 U.S. 210 (1944); *Texas & Pacific R.R.* v. *Rigsby*, 241 U.S. 33 (1916). Cf. *Bivens* v. *Six Unknown Named Agents*, 403 U.S. 388 (1971); *Bell* v. *Hood*, 327 U.S. 678 (1946).

There are compelling reasons why the courts have been particularly willing to recognize private rights of action under the antifraud provisions of the federal securities laws. Those provisions are designed to protect specific classes of injured parties. Moreover the SEC—the agency charged with administration and enforcement of the federal securities laws—does not have sufficient resources alone to enforce the many provisions of the statutes. Absent judicial recognition of private rights of action, the federal securities laws most assuredly would fail to provide the effective regulation over the securities industry which Congress intended. In finding an implied right of action under Section 14(a) of the 1934 Act, the Supreme Court held in *J. I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 432, that "Private enforcement . . . provides a necessary supplement to Commission action", and went on to state:

> "[I]t is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." *Id.* at 433.

Act, 74 Mich. L. Rev. 308 (1975); Lybecker, Advisers Act Developments, 8 Review of Securities Regulations 927, 934 (April 23, 1975); Note, *Bolger* v. *Laventhol, Krekstein, Horwath & Horwath: Private Rights of Action Under the Investment Advisers Act*, 48 Temple L.Q. 433 (1975).

Applying these principles, the courts of appeals consistently have recognized an implied right of action under the Investment Companies Act—the companion to the Advisers Act. *Moses* v. *Burgin*, 445 F.2d 369 (1 Cir.), *cert. denied*, 404 U.S. 994 (1971); *Herpich* v. *Wallace*, 430 F.2d 792, 815 (5 Cir. 1970); *Esplin* v. *Hirschi*, 402 F.2d 94, 103 (10 Cir. 1968), *cert. denied*, 394 U.S. 928 (1969); *Taussig* v. *Wellington Fund, Inc.*, 313 F.2d 472, 476 (3 Cir.), *cert. denied*, 374 U.S. 806 (1963); *Brown* v. *Bullock*, 194 F.Supp. 207 (S.D.N.Y.), *aff'd*, 294 F.2d 415, 420-21 (2 Cir. 1961) (en banc). It is well settled that implied rights of action exist under Section 10(b) of the 1934 Act and Rule 10b-5, which contain substantially the same language as Section 206 of the Advisers Act. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730 (1975); *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, *supra*, 404 U.S. at 13 n. 9; *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783, 787 (2 Cir. 1951); *Kardon* v. *National Gypsum Co.*, 69 F.Supp. 512 (E.D.Pa. 1946). Judicially implied rights of action also have been found under Section 14(a) of the 1934 Act, *J. I. Case Co.* v. *Borak*, *supra*, and under the Public Utility Holding Company Act of 1935, *Goldstein* v. *Groesbeck*, 142 F.2d 422 (2 Cir.), *cert. denied*, 323 U.S. 737 (1944).

Against this background, we turn to the question whether a private right of action should be implied under Section 206 of the Advisers Act.

In *Cort* v. *Ash*, 422 U.S. 66, 78 (1975), the Supreme Court suggested that the following factors be considered in determining "whether a private remedy is implicit in a statute not expressly providing one":

> "First, is the plaintiff 'one of the class for whose *especial* benefit the statute was enacted' . . . —that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative

> intent, explicit or implicit, either to create such a remedy or to deny one? . . . Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? . . . And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?"

We believe that each of these factors point unmistakably toward recognition of an implied right of action under Section 206 of the Advisers Act. See *Piper* v. *Chris Craft Industries, Inc.* —— U.S. ——, 45 U.S.L.W. 4182, 4192-93 (U.S. Sup. Ct. Feb. 22, 1977).

The purpose of the Advisers Act was "to protect the public and investors against malpractice by persons paid for advising others about securities."[18] The Act was designed for the "especial" benefit of persons relying upon their investment advisers for advice. *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186-91 (1963).

Congress enacted the Advisers Act, as it had earlier securities legislation, mindful of the need for *federal* regulation of the securities industry. As the Senate Committee Report emphasized:

> "The nature of the functions of investment advisers, their increasing widespread activities, their potential influence on security markets and the dangerous potentialities of stock market tipsters imposing upon unsophisticated investors, convinces the committee that protection of investors requires the regulation of investment advisers on a national scale.
>
> The report of the Commission to the Congress and the record before the committee is clear that *the solution of the problems and abuses of investment advisory services . . . cannot be effected without Federal legislation.*" (emphasis added) S. Rep. No. 1775, 76th Cong., 3d Sess. 21 (1940).

18 S. Rep. No. 1760, 86th Cong., 2d Sess., 1 (1960).

The House Committee Report which accompanied the 1940 bill stated:

> "The essential purpose of title II of the bill is to protect the public from the frauds and misrepresentations of unscrupulous tipsters and touts and to safeguard the honest investment adviser against the stigma of the activities of these individuals by making fraudulent practices by investment advisers unlawful." H.R. Rep. No. 2639, 76th Cong., 3d Sess., at 28 (1940).

We are not aware of any statement indicating that Congress considered the problem of private actions under the Advisers Act at the time of its enactment. Nor is there any indication that the SEC considered this matter when it adopted Rule 206(4)-1. Absent specific statements of legislative intent, we must examine the legislative purposes underlying the Act.

As stated above, the courts consistently have recognized that the Commission's resources are inadequate to the task of policing alone the federal securities laws. In enacting the 1940 legislation, Congress intended to provide effective *federal* regulation of an important segment of the securities industry. Failure to recognize a private right of action under the Advisers Act would effectively frustrate that purpose. We hesitate to reach such a result absent clear evidence from the Act's legislative history that private actions were not intended.

Turning to related provisions of the Advisers Act, Section 215(b), 15 U.S.C. §80b-15(b) (1970), provides that any contract in violation of the Act shall be void. As the courts have held in construing nearly identical provisions of the other securities acts, the language of Section 215(b) strongly suggests that a private remedy should be implied and that such a remedy would be consistent with the other provisions of the Act. *Fischman* v. *Raytheon Mfg. Co.*,

supra, 188 F.2d at 787 n. 4; *Kardon* v. *National Gypsum, supra,* 69 F.Supp. at 514; see *Slavin* v. *Germantown Fire Ins. Co.,* 174 F.2d 799, 815 (3 Cir. 1949).

In arguing that a private right of action should not be recognized under the Advisers Act, appellees point to the difference between the language found in the jurisdictional provision of the Advisers Act and similar provisions of other securities acts.[19] Section 214 of the Advisers Act, 15 U.S.C. §80b-14 (1970) in relevant part provides:

> "The district courts of the United States . . . shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this subchapter or the rules, regulations or orders thereunder."

By contrast, Section 22 of the 1933 Act, 15 U.S.C. §77v (1970), Section 27 of the 1934 Act, 15 U.S.C. §78aa (1970), and Section 44 of the Investment Companies Act, 15 U.S.C. §80-a-43 (1970), provide that the district courts shall have

19 Appellees also argue that recognition of a private right of action would be inconsistent with Section 209(e) of the Act and other enforcement provisions which provide that the Commission "may in its discretion bring an action" for injunctive relief. We find no merit in this argument. *The enforcement powers given the Commission under the Advisers Act are virtually identical to those of the other securities acts under which we have recognized implied private rights of action.* Unlike the Securities Investor Protection Act, which was involved in *Securities Investor Protection Corp.* v. *Barbour,* 421 U.S. 412 (1975), the Advisers Act in general, and the antifraud provisions in particular, do not manifest a specific legislative intent to restrict enforcement to the Commission. Here, private suits would be consistent with Commission action. The provision allowing the Commission the usual discretion to sue simply makes it clear that the SEC is not *compelled* to sue in *every* case. Indeed it would be extraordinary for Congress to require an agency to bring enforcement proceedings in every instance. The Court in *Barbour* distinguished *J. I. Case* v. *Borak,* where the Court had found private suits a necessary supplement for—rather than a hindrance to—Commission action. 421 U.S. at 423.

jurisdiction of "all suits in equity *and actions at law* brought to enforce any liability or duty created by" those Acts.

Appellees argue that the omission of any reference to "actions at law" in Section 214 manifests a legislative intent to preclude private rights of action under the Advisers Act. We disagree. In our view, the reason for this omission is that each of the other Acts whose jurisdictional provisions refer to "actions at law" contains one or more sections *expressly* granting injured parties a private right of action for damages.[20] There is no provision in the Advisers Act which *expressly* provides for private actions; since it is a less complex statute, containing no express grants of right of action to private parties, a reference to 'actions at law' would be superfluous.

There is not a shred of evidence in the legislative history of the Advisers Act to support the assertion that Congress intentionally omitted the reference to "actions at law" in order to preclude private actions by investors. Section 215, like the jurisdictional provisions of the other securities acts, was drawn to provide jurisdiction over actions expressly authorized by the statute. Far from indicating that Congress ever considered the matter of private actions in drafting Section 214, the only legislative history indicates that Congress attached no great importance to its omission. In their only references to Section 214, both the Senate and House Reports stated that the enforcement provisions of the Advisers Act were "generally comparable" to those of the Investment Companies Act, whose

20 See Sections 11 and 12 of the 1933 Act, 15 U.S.C. §§77k and 77l (1970); Sections 9(e), 16(b) and 18 of the 1934 Act, 15 U.S.C. §§78i(e), 78p(b) and 78r (1970); Sections 16(a) and 17(b) of the Public Utility Holding Company Act of 1935, 15 U.S.C. §§79p(a) and 79(q)(b) (1970); Section 323(a) of the Trust Indenture Act of 1939, 15 U.S.C. §77www(a) (1970); and Section 30(f) of the Investment Companies Act of 1940, 15 U.S.C. §80a-29(f) (1970).

jurisdictional provision contains the "actions at law" language. S. Rep. No. 1775, 76th Cong., 3d Sess., at 23 (1940); H. R. Rep. No. 2639, 76th Cong., 3d Sess., at 30 (1940).[21]

In dealing with private rights of action under other securities acts, courts have referred to the "actions at law" language under the jurisdictional provisions to indicate the overall structure of those acts. But the "actions at law" language has never been relied upon as evidence that Congress *explicitly* considered the matter of private damage actions under the particular substantive provision in question. Had Congress provided explicitly for private damage actions it would be unnecessary to consider whether the remedy should be judicially implied. Indeed, under the antifraud provisions of other securities acts courts have recognized the *absence* of any legislative intent either to create or to deny private rights of action for damages. Here, as under the other statutes, it is clear that Congress simply did not consider the matter.[22]

21 As originally introduced in the House and Senate, the proposed Advisers Act merely incorporated the jurisdictional provision of the Investment Companies Act. Section 203 of S. 3580 and H. R. 8935. The Investment Companies Act, in turn, had adopted the same language as found in Section 25 of the Public Utility Holding Company Act of 1935, 15 U.S.C. §79y. Section 40(a)(1) of S. 3580 and H.R. 8935. As reported out of the committees, the bills omitted all references to other statutes; and the Advisers Act was given its own jurisdictional provision which did not contain any reference to "actions at law brought to enforce any liability . . . ."

22 We need not decide whether the language of Section 214 which grants to the district courts jurisdiction over "violations of this subchapter or the rules, regulations, or orders thereunder" might cover private damage actions. See *Bolger* v. *Laventhol, Krekstein, Horwath & Horwath, supra,* 381 F.Supp. at 264. Courts have implied private rights of action under statutes which have no separate jurisdictional provision for civil damage suits. *Texas & Pacific R.R. Co.* v. *Rigsby, supra,* 214 U.S. at 39; *Odell* v. *Humble Oil & Refining Co.,* 201 F.2d 123, 126 (10 Cir. 1953); *Narramore* v. *Cleveland, C.C. & St. L. Ry. Co.,* 96 F. 298, 300 (6 Cir. 1899). Moreover, the general federal question jurisdictional provision, 28 U.S.C. §1331 (1970), would apply here. See *Brown* v. *Bullock, supra.* 294 F.2d at 418.

The Supreme Court, in considering a different issue under the Advisers Act in *SEC* v. *Capital Gains Research Bureau, Inc., supra,* 375 U.S. at 195, emphasized that the Act should "be construed like other securities legislation 'enacted for the purpose of avoiding frauds,' not technically and restrictively, but flexibly to effectuate its remedial purposes." (footnote omitted). We find that particularly cogent here where we are asked to determine whether there should be a private right of action to recover damages for what may be clear violations of the Act. Moreover, mindful of the Supreme Court's admonition in *J. I. Case* v. *Borak, supra,* 377 U.S. at 433, we believe that we should provide "such remedies as are necessary to make effective the congressional purpose", rather than adopt a construction that would effectively defeat the purpose of providing federal regulation over an important segment of the securities industry.

We hold that there is an implied private right of action under Section 206 of the Advisers Act.[22a]

22a Our concurring-dissenting colleague, in a characteristically thoughtful and innovative opinion, urges that a private right of action for damages should not be implied under the Advisers Act. We suggest that Judge Gurfein's opinion be read in the light of the following observations.

First, the basic premise of the dissent is the assumption that the Advisers Act was intended to provide "a *compulsory census* of investment advisers, and not . . . a pervasive regulatory scheme." (emphasis added). Post, p. 6250. A careful reading of the Advisers Act shows that, as enacted, it requires far more than a census. As the last of the series of federal securities laws enacted between 1933 and 1940, it is an integral part of a comprehensive regulatory scheme intended by Congress to eliminate certain abuses in the securities industry. The Supreme Court in *SEC* v. *Capital Gains Research Bureau, Inc., supra,* in referring to a fundamental purpose of the Advisers Act and its relationship to the other federal securities regulatory acts, stated:

> "The Investment Advisers Act of 1940 was the last in a series of Acts designed to eliminate certain abuses in the securities industry, abuses which were found to have contributed to the stock market crash of 1929 and the depression of the 1930's. It was preceded by the Securities Act of 1933, the Securities Exchange Act of 1934,

(3) *Compensable Damages Under the Advisers Act*

Appellees contend that plaintiffs have not alleged compensable damages under the Advisers Act. They argue

the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, and the Investment Company Act of 1940. A fundamental purpose, common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry. As we recently said in a related context, 'It requires but little appreciation . . . of what happened in this country during the 1920's and 1930's to realize how essential it is that the highest ethical standards prevail' in every facet of the securities industry. *Silver* v. *New York Stock Exchange,* 373 U.S. 341, 366." (footnotes omitted). 375 U.S. at 186-87.

Second, while we do not claim the expertise of our dissenting colleague concerning hedge funds, pp. 6253-6254 & n. 1, we do suggest that much of the speculation of the dissent with respect to the investment policy of the general partners as managers of the fund (e.g. whether the partnership "was going to operate in the most speculative of investment activities", post, p. 2653) and the intentions of plaintiffs in becoming limited partners, might better await the trial on the merits to which we have held plaintiffs are entitled. For after all, the posture of the case as it came to us from the district court was the dismissal of the complaint on the ground that plaintiffs realized a net profit on their overall limited partnership investments and therefore failed to prove damages compensable under the federal securities laws. 392 F.Supp. 740. While this holding of the district court is rejected, all we hold with respect to plaintiffs' Advisers Act claim is that they are entitled to their day in court and an opportunity to prove their claim. Post, pp. 2653-2654. At that time, when the credibility of witnesses can properly be determined, many of the speculative factual issues suggested by the dissent appropriately can be resolved.

Finally, and perhaps of chief significance, the dissent does not dispute the eloquent absence of evidence that Congress ever considered allowing damages, as distinguished from injunctive relief, under the Advisers Act. The question of damages was not considered because the matter of a private right of action was not considered. The dissent's massive reliance upon the omission of the "actions at law" language in the Advisers Act and its inclusion in the jurisdictional provisions of other statutes, we think is misplaced. Judicially implied private rights of action have been recognized under various sections of the securities laws even though those sections, unlike other sections of the same statutes, contain no explicit provision for private actions. Here likewise there is no evidence that the omission was meant to exclude private actions. In this respect the present

that plaintiffs themselves were neither purchasers nor sellers of securities and that their claims are speculative because they are based upon the assertion that plaintiffs would have withdrawn from FBA earlier had they been told the truth about the partnership's investments. We disagree.

At the outset, we find no basis for appellees' assumption that plaintiffs' only alternative, had they learned the truth earlier about FBA's high percentage of investments in unregistered securities, was to withdraw their funds. Plaintiffs might have tried to persuade the general partners to conform the firm's investments to the conservative policy they had represented. Failing that, plaintiffs might have mobilized the other limited partners to exert pressure on the general partners.

We find appellees' reliance upon *Blue Chip Stamps* v. *Manor Drug Stores, supra,* on this aspect of the instant case to be misplaced.

The *Blue Chip* decision was based on the *express language* of Section 10(b) and Rule 10b-5 requiring a fraud "in connection with the purchase or sale of any security." [23]

case is plainly different in a significant legal respect from *National R.R. Passenger Corp.* v. *National Ass'n of R.R. Passengers,* 414 U.S. 453 (1974), relied upon by the dissent, where "the legislative history of the Amtrack Act provide[d] a clear and convincing expression of Congress' intent to preclude anyone except the Attorney General and in certain situations an employee or his duly authorized representative from maintaining an action under the Act against petitioners" (414 U.S. at 465 (Justice Brennan concurring)), and transportation policies not pertinent here militated in favor of such a limitation. No such history or policies are to be found here.

23 The holding in *Blue Chip* was that persons who claimed that they had been fraudulently induced *not* to purchase securities were not within the class of persons protected by Section 10(b) of the 1934 Act and Rule 10b-5, under which recovery is limited to funds "in connection with the purchase or sale" of securities. In reaffirming the doctrine of *Birnbaum* v. *Newport Steel Corp.,* 193 F.2d 461 (2 Cir.), *cert. denied,* 343 U.S. 956 (1952), the Court also stated that "actual shareholders in the issuer

Neither Section 206 of the Advisers Act nor Rule 206 (4)-1 contains any such requirement. While the Court stated in *Blue Chip* that the purchaser-seller limitation under Section 10(b) protected against vexatious and speculative claims, it did not say or suggest that *any* claim would be too speculative for recovery under the other securities acts unless the plaintiff was a purchaser or seller. Indeed the Court acknowledged that provisions of the other securities acts afford rights of action to persons who are not purchasers or sellers. 421 U.S. at 733-34.

Acceptance of appellees' contention, moreover, would lead to a construction of the Advisers Act clearly inconsistent with the intent of Congress. As indicated above, Congress intended to protect investors against frauds committed by investment advisers who managed their clients' funds, as well as frauds committed by advisers who did not make purchases and sales for their clients. If the claims of a client whose adviser managed his funds were to be held to be too speculative simply because the client failed to allege that he would have taken some remedial action if he had known the truth, a large segment of those investors whom Congress meant to protect would be excluded from the Act's coverage. To accept appellees' contention would lead to the incongruous result that an investor's claims would be speculative even if the adviser had made fraudulent statements to conceal the fact that he was stealing his client's funds.

We believe that the differences in the language and purposes of Section 10(b) of the 1934 Act and Section 206 of the Advisers Act distinguish the instant case from *Blue*

who allege that they decided not to sell their shares because of an unduly rosy representation or a failure to disclose unfavorable material" might not be able to sue under Section 10(b) and Rule 10b-5. *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 737-38.

Chip. We also note that the policy considerations expressed in *Blue Chip* lend no support to appellees' arguments.[24] Under Section 206, the plaintiff class is limited to the investment adviser's own clients. Since the investment adviser is compensated for his services, both client and adviser understand that the client will rely upon the adviser's judgment and advice. To characterize the client's reliance as speculative is to ignore the essence of the relationship. See *Galfand* v. *Chestnutt Corp.*, 545 F.2d 807 (2 Cir. 1976). Plaintiffs here allege fraudulent representations relating to specific purchases and sales of unregistered securities, thus providing a definable measure of damages. And a defrauded client may be deprived of *numerous* means of controlling his adviser's conduct and the management of his investments, only one of which is the remedy of withdrawing his funds altogether. We believe that the limited uncertainties involved in a case such as this are not sufficient to bar recovery on an otherwise valid claim; and they are adequately offset by requiring proof that the misrepresentations were material and proof of reliance.[25]

24 In interpreting the express language of Section 10(b) and Rule 10b-5 in *Blue Chip*, the Court expressed concern about suits by persons who neither purchased nor sold securities but who claimed that they would have purchased or sold securities but for false representations made by someone whom they might not even have known. The Court noted that the "purchase or sale" requirement protected against vexatious suits by a potentially limitless class of plaintiffs and avoided the difficult questions of determining whether a plaintiff would or would not have purchased or sold securities but for the defendant's representations. *Id.* at 745-47.

Far from holding that claims of persons who were neither purchasers or sellers would be too speculative under the other securities acts, the Court interpreted the express language of Section 10(b) and Rule 10b-5. And the Court expressly noted that many of the other securities acts have no "purchase or sale" requirement. 421 U.S. at 733-34.

25 Even the claims of a person who has purchased or sold securities are not free of uncertainties. A purchaser or seller necessarily alleges that he would *not* have made the purchase or sale had he known the true facts.

We hold that plaintiffs have alleged damages compensable under Section 206 of the Advisers Act.[26]

IV. Measure of Damages on Remand

In view of our remand for trial on the Advisers Act claim, we believe that the district court is entitled to some guidance on the proper measure of damages.

We do not agree with the district court's holding, 392 F.Supp. 740, that, since plaintiffs realized a net profit on their overall limited partnership investment, they failed to prove damages compensable under the federal securities laws.

This is not to say, however, that a plaintiff may recover for losses, but ignore his profits, where both result from a *single* wrong. In determining on remand whether plain-

Although the claims of persons who neither purchased nor sold securities, in individual cases, may be *less* speculative than the claims of actual purchasers or sellers, *Blue Chip* weeds out suits by persons who may have had no interest in a security until discovering that someone has made a fraudulent statement which may give rise to a lawsuit. In view of the settlement value of a securities suit, this is an important consideration. Obviously an investor who has paid for the advice of his adviser is not the type of disinterested by-stander at whom the *Blue Chip* decision was primarily aimed.

26 It is important to note that there is no issue in this case as to whether an investor may recover for negligent misrepresentations by his investment adviser. See *Ernst & Ernst* v. *Hochfelder, supra; Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1298-1301 (2 Cir. 1973) (distinguished in *Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at 209; *SEC* v. *Capital Gains Research Bureau, supra.* Plaintiffs here have alleged that defendants' misrepresentations were *intentional.* Whether defendants thought that the price of the unregistered securities would rise or not has no bearing on the issue of scienter. Although the general partners' own funds were part of FBA's pooled assets, they would be liable under Section 206 if they *intentionally* deceived the limited partners to prevent the limited partners from withdrawing their contributions *or for any other reason. Ernst & Ernst* v. *Hochfelder, supra.* Scienter does not require a showing of intent to cause a loss to a plaintiff. *SEC* v. *Capital Gains Research Bureau, supra,* 375 U.S. at 192 n. 39.

tiffs have sustained any damages from the alleged fraudulent investments, the district court should determine, first, at what point defendants' representations became fraudulent due to the increasing proportion of portfolio investments in unregistered securities. The court then should compute the total net losses on all holdings of unregistered securities due to changes in price *after* that date. Finally, the court should determine what proportion of FBA's holdings was inconsistent with representations that the partnership was in a "most conservative posture" and the other representations made to the limited partners. The proper measure of damages then would be that part of net losses incurred on unregistered securities after the point when the defendants' representations became fraudulent which stems from the portion of those investments inconsistent with defendants' representations.[27]

We of course do not intimate any views as to whether plaintiffs in fact have sustained *any* damage and, if so, *how much.* All we hold is that they are entitled to their day in court and an opportunity to prove, if they can, their claim under the Advisers Act.

Affirmed as to the dismissal of the Securities Exchange Act claim; as to the dismissal of the Investment Advisers Act claim, reversed and remanded for trial.

27 The cut-off price for such unregistered securities in the portfolio at the time plaintiffs withdrew should be the value assigned to such securities by the general partners, since that presumably is what plaintiffs received. This would provide the closing out price for loss-netting purposes with respect to securities remaining in the portfolio at the time of plaintiffs' withdrawal.

GURFEIN, *Circuit Judge,* concurring and dissenting:

I concur in the affirmance of the dismissal of the § 10(b) claim.

With great respect for my brother Timbers as a master of securities law, I must respectfully dissent from the holding that, under this complaint, we should imply a private right of action at law for damages for alleged violation of § 206 of the Investment Advisers Act, 15 U.S.C. § 80b-6 ("Advisers Act") by these limited partners of a speculative hedge fund.[1]

According to the majority, the issue in this case is whether to imply a *private* right of action. It therefore draws an analogy to other securities act provisions under which private rights of action have been implied. It seems to me, however, that the issue is rather whether a private action at law for *damages* should be implied. With refer-

1 The Hedge Fund partnership agreement gave the general partners the following powers:

> "(a) To purchase, hold and sell stocks, bonds and other securities; (b) to sell stocks, bonds and other securities short and to cover such sales; (c) to purchase, hold, sell and otherwise deal in put and call options and any combination or combinations thereof; (d) to purchase, hold, sell, sell short and cover, and borrow from brokers for that purpose, commodity contracts and to purchase, hold, sell and otherwise deal in commodities generally dealt in on commodity or produce exchanges, provided, however, that Partnership funds used for the purpose of dealing in commodities and commodity contracts shall not exceed at the time of any purchase or commitment ten (10) percent of the net worth of the Partnership at July 1, 1965 or at the beginning of any calendar year thereafter, as the case may be; (e) to conduct margin accounts with brokers; (f) to open, maintain and close bank accounts; (g) to sign checks; (h) to pledge securities for loans; (i) to engage in the business of advising and counselling on investments and to enter into agreements therefor; and (j) generally, to act for the Partnership in all matters incidental to the foregoing."

The original partnership agreement was amended twice, but the amendments did not affect the management's broad discretionary powers.

ence to that issue, I think that the Investment Advisers Act differs significanty from the securities statutes upon which the majority draws for support.

The legislative history of the Advisers Act indicates that it was a tentative attempt to effect a "compulsory census" of investment advisers by requiring registration rather than to provide a full regulatory scheme. David Schenker, representing the SEC, testified in the Senate Hearings:

> Therefore, our fundamental approach to this problem is in the first instance, before we could intelligently make an appraisal of the economic function or of the abuses which might exist in that type of organization, to see if we could not get something which approximated *a compulsory census. Fundamentally that is the basic approach of title 2.* [The Advisers Act]. We first would like to find out how many people are engaged in this business, what their connections are, what is the extent of their authority, what is their background, who they are, and how they handle the people's funds" (emphasis added).

Hearings on S. 3580 before the Subcomm. of the Senate Comm. on Banking & Currency, 76 Cong., 3d Session 48. *See also* S. Rep. No. 1760, 86th Cong., 2d Sess., U.S. Code Cong. & Adm. News 3502. There are other indications that "as enacted, the Investment Advisers Act represented a compromise between the SEC and the investment advisory industry." *See Note, Private Causes of Action Under Section 206 of the Investment Advisers Act,* 74 Mich. L. Rev. 308, 319-20 & n.69 (1975).[2] It is in light of this cautious approach taken by Congress in enacting the Advisers Act as tentative legislation that Section 214, the provision which appears to allow only suits in equity, should be read.

2 *See* p. 6232 & n. 5 *infra.*

Section 214 is unlike the corresponding sections in the other Acts. As my Brother Timbers notes, the Advisers Act gives the district courts jurisdiction, concurrently with state courts, only "of all suits in equity to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder." The other Acts, by contrast, provide jurisdiction not merely over "all suits in equity," but also over "actions at law brought to enforce any liability or duty created thereby, or to enjoin any violation of this subchapter, or the rules, regulations or orders thereunder," *e.g.*, Investment Company Act of 1940, § 44, 15 U.S.C. § 80a-43, an act passed together with the Advisers Act in a single bill.[3] For similar language in other Acts, *see* majority opinion p. 6233, n.20.[4]

3 It seems to me of some significance that early drafts of the Advisers Act, including S. 3580 and H.R. 8935, filed on March 14, 1940, merely incorporated by reference § 40 of the Investment Companies Act, which did include the reference to "actions at law." After the conclusion of four weeks of Senate hearings on April 26, however, representatives of the industry met with the SEC to negotiate changes in the proposed bill. *See Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 76th Cong., 3d Sess. 72 (1940); 86 Cong. Rec. 10069 (1940) (remarks of Senator Wagner). The result was a new draft, which finally met the approval of the industry, *see House Hearings* at 95; Jaretski, *The Investment Company Act of 1940*, 26 Wash. L. Rev. 303, 309-10 (1941), and which for the first time contained a separate jurisdictional provision referring to "suits in equity" but omitting the reference to "actions at law" which the majority seeks to restore to the statute.

4 While the majority opinion does not rely on the circumstance that jurisdiction is conferred over "violations" of the statute and rules thereunder to imply a cause of action for damages at law, a district court has done so. *See Bolger* v. *Laventhol, Krekstein, Horwath & Horwath*, 381 F. Supp. 260 (S.D.N.Y. 1974). I do not agree. "Violations" in the context means criminal violations, and violations on the civil side are limited to suits in equity. This is made clear by the venue provisions of § 214: (1) "any criminal proceeding" may be brought in the district court wherein any act or transaction constituting the violation occurred; (2) "any suit or action to enjoin any violation may be brought in . . . ." There is still no reference to an "action at law."

The attempted withholding of jurisdiction over actions at law in the Advisers Act indicates that Congress was not intending to provide for *any* liability beyond injunctive relief.[5] As Mr. Justice Powell noted in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 756 (concurring), "[t]he starting point in every case involving construction of a statute is the language itself." The majority opinion explains that the language of § 214 differs from the language of the jurisdictional sections in every other Securities Act because "each of the other Acts whose jurisdictional provisions refer to 'actions at law' contains one or more sections *expressly* granting injured parties a private right of action for damages,'" and hence, required the jurisdictional provision for that reason.[6]

5 One might indeed argue that there is lack of subject-matter *jurisdiction* to enforce actions at law for damages for violations of the Advisers Act because of the lack of any specific statutory authorization, but I do not urge that. There is jurisdiction under a broad reading of the "arising under" clause of 28 U.S.C. § 1331. *Cf. Illinois* v. *City of Milwaukee*, 406 U.S. 91, 98 (1972); *Romero* v. *International Terminal Operating Co.*, 358 U.S. 354, 393 (1959) (Brennan, *J.*, concurring and dissenting); *Bell* v. *Hood*, 327 U.S. 678 (1946). *See also Tunstall* v. *Brotherhood of Firemen*, 323 U.S. 210 (1944) ("arising under" 28 U.S.C. § 1337). The majority correctly states that plaintiffs allege jurisdiction under § 214 of the Advisers Act, the very section that does *not* provide for "actions at law," but since the pleading can be amended I make no point of the insufficiency of a proper jurisdictional statement. Even if an implied claim for relief is judge-made, it may "arise under the laws of the United States."

6 The reason given by the majority is not persuasive, for it fails to note that in every single case in which an express civil liability is created in *any* of the Acts, the jurisdiction has *already* been stated in the very section creating the express liability. Thus, § 11 of the 1933 Act, 15 U.S.C. § 77k, *itself* provides that "any person acquiring such security . . . may, either at law or in equity, in any court of competent jurisdiction, sue . . . ." Section 12 of the 1933 Act, 15 U.S.C. § 77l, *itself* provides that the purchaser "may sue either at law or in equity in any court of competent jurisdiction . . . ." To the same effect, *see* Section 9(e) of the 1934 Act, 15 U.S.C. § 78i(e); Section 16(b) of the 1934 Act, 15 U.S.C. § 78p(b); Section 18 of the 1934 Act, 15 U.S.C. § 78r; Section 16(b) of the Public Utility Holding Company Act of 1935, 15

But the more cogent question is why the Advisers Act, as distinguished from every other securities act, does not provide for *any express* civil liability in damages. The majority offers no explanation for such an omission which must have been a studied omission. I think it is highly relevant that in *each* of the other Acts Congress itself did provide for some *express* civil liability, yet under the Advisers Act it failed to include a single section imposing liability for damages. Congress, for example, could have provided an express damage remedy for misrepresentations in the registration statement of the advisers as it did for misrepresentations of the registration statement of the underwriter, 15 U.S.C. § 77k(a)(5). This indicates

U.S.C. § 79p(b); Section 17(b) of that Act, 15 U.S.C. § 79q(b); Section 323(a) of the Trust Indentures Act, 15 U.S.C. § 77www(a); Section 30(f) of the Investment Companies Act, 15 U.S.C. § 80a-29(f). The better explanation, it seems to me, for the general jurisdictional provision in each Act—"the District Courts of the United States . . . shall have jurisdiction" etc.—is Congress' fear that general federal question jurisdiction under 28 U.S.C. § 1331 might not establish jurisdiction in the *federal* courts over securities law claims, particularly when the jurisdictional amount was lacking. The separate jurisdictional provisions associated with the several sections of the securities acts creating substantive liability referred only to "any court of competent jurisdiction," and hence left open the question of whether the federal courts were in fact courts of "competent jurisdiction." Thus, an independent jurisdiction was conferred on the federal courts by the general provision of each statute (and in the case of the Securities Exchange Act, exclusive jurisdiction). In short, the internal sections conferred general jurisdiction. The jurisdictional section was drawn as broadly as possible to confer clear *federal* jurisdiction.

The majority opinion seeks to draw support from the fact that the Senate and House Reports stated that the enforcement provisions of the Advisers Act were "generally comparable" to those of the Investment Companies Act. *Ante* at 6233. Aside from the fact that this begs the crucial question—whether the Acts were comparable in this particular respect—it ignores what was in my view the more likely meaning of "generally comparable" as applied to the enforcement provisions: that is, that the Advisers Act is "generally comparable" to the Investment Company Act in that both provide for the concurrent jurisdiction of state and federal courts, as distinguished from the Exchange Act in which federal jurisdiction is made exclusive.

rather that, in its cautious approach to the regulation of investment advisers, Congress was not yet ready to impose *any* civil liability for damages.

The majority holds, nonetheless, that a private damage action should be implied in this case "to implement the statute's underlying purposes." It notes that persons relying upon investment advisers for advice, for whose "especial benefit" the Act was adopted, *see Cort* v. *Ash,* 422 U.S. 66, 78 (1975), will benefit from a private damage action. *Ante*, pp. 6229-6230, *citing SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 186-91 (1963).[7] Such reasoning it seems to me has become somewhat outmoded in the light of the current standards of interpretation announced in *Cort* v. *Ash, supra.* The *four* factors mentioned in *Cort* v. *Ash* are not mere surplusage to the theme that the beneficent purpose of the legislation is, by itself, sufficient warrant for the implication of a claim for private relief.[8] Such

7 That case was not, of course, a damage action, nor was it brought by a private party.

8 The majority reasons that Section 215(b) of the Advisers Act, 15 U.S.C. § 80(b)-15(b) (1970), which provides that any contract violating the Act shall be void, strongly suggests that a private remedy should be implied. *Ante,* p. 6231, *supra.* But it does violence to the criteria enunciated in *Cort* to imply an action simply because a contract is made void, or to recognize an actionable tort, simply because a statute prohibits particular conduct. *Cf.* Note, *Section 206 Private Actions,* 74 Mich. L. Rev. 308, 312 n.19 (1975). Significantly, the SEC in its *amicus* brief does not rely on § 215(b) of the Act.

Even if the fact that a statute renders certain contracts void were deemed *ipso facto* to create a private right of action, on the theory that this provision could be vindicated only by the private parties to the contract, it of course by no means follows that a *damage* remedy is proper. Rescission or restitution are, aside from damages, remedies ordinarily available when a contract is void. Significantly, rescission is an equitable remedy, *see* 5 Corbin on Contracts § 1103, so that implication of a private right of action for rescission and restitution under § 215(b) would be well within the jurisdictional grant of § 214, and consistent with the notion that it is only *actions at law* which are inconsistent with the statutory scheme.

a single criterion is also inadequate because a statute can have more than one "beneficient purpose"—here, to protect investors but also to avoid undue disruption of the investment advisory industry. To put it another way, Congress may intend a statute to protect investors—but not necessarily without limit. Countervailing considerations may result in something less than an imposition of civil liability for money damages. The majority opinion ignores this problem of statutory construction, in my view, because it gives insufficient weight to the second factor listed in *Cort:* "is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one?"[9] As shown above, there *is* implicit legislative intent to deny such a remedy.[10]

The majority urges that there is no evidence that Congress intentionally sought to preclude private damage actions. *Ante,* p. 6233. But there is surely no "clear evidence" that Congress affirmatively intended private actions for damages to lie for violation of § 206. And we have been instructed recently in *National Railroad Passenger Corp.* v. *National Ass'n of Railroad Passengers,* 414 U.S. 453, 458 (1974) (*"Amtrak"*) that "'when a statute limits a thing to be done in a particular mode, it includes the

9 Analytically, it would be equally proper to say that implication of a private action under the Advisers Act is not "consistent with the underlying purposes of the legislative scheme." *Cort, supra,* at 78. For though such a remedy may be consistent with the goal of protecting customers of investment advisers, it is hardly consistent with the desire not to subject advisers to monetary liability, at least, until further study by Congress.

10 The situation in which there is express statutory provision for one form of proceeding, as here, for equitable but not legal actions, should be distinguished from the situation in which Congress gives broad but unspecified remedial scope to the statute, *see, e.g.,* § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b). In the latter situation, implication of some private actions may be not merely consistent with the legislative purpose, but necessary in order fully to effectuate it.

negative of any other mode,'" *quoting Botany Mills* v. *United States,* 278 U.S. 282, 289 (1929). Section 214 expressly confers jurisdiction over suits in equity only, and the Act as a whole does not provide anywhere for actions at law. Under the *Amtrak* formulation, when Congress limits relief to equitable relief, "it includes the negative of any other mode"—monetary liability. In *Amtrak* Mr. Justice Stewart observed that, in determining whether a private action would lie, this rule of statutory construction should yield only "to clear contrary evidence of legislative intent," 414 U.S. at 458, a situation that does not exist in the case of the Advisers Act.

Similarly, in *Securities Investor Protection Corp.* v. *Barbour ("SIPC"),* 421 U.S. 412 (1975), Mr. Justice Marshall noted that where there is express statutory provision for one form of proceeding, this "ordinarily implies that no other means of enforcement was intended by the Legislature," 421 U.S. at 419, again emphasizing that the implication would yield only to "clear contrary evidence of legislative intent." I think that my brothers turn this test backwards. And as we have seen, there are strong reasons for believing that not only is there no "clear contrary evidence of legislative intent" but rather that whatever evidence exists looks the other way.

That a statute explicitly provides for private rights of actions in some sections does not, of course, preclude the implication of other actions under different sections of the same Act. *J.I. Case Co.* v. *Borak,* 377 U.S. 426 (1964); *see* 6 L. Loss, *Securities Regulation,* 3869-73 (Supp. 1969). *Cf.* 1 A. Bromberg, *Securities Law: Fraud* § 2.4(1) (1975); *Note, Private Rights of Action Under* Amtrak *and* Ash: *Some Implications for Implication,* 123 U. Pa. L. Rev. 1392, 1419-20 (1975).[11] But the Advisers Act is a statute

11 In *Borak,* the Court relied not only on § 27's provision for "actions at law" but also on its language "brought to enforce any liability or

which completely omits *any* damage actions whatever, even though *otherwise analogous statutes* do not. To find a negative implication in such a case is more than a mechanical rule of construction. For while under the Securities Act the failure to include express remedies for each substantive section probably is due to considerations not relevant to the implication question, *see Note, supra,* 123 U. Pa. L. Rev. at 1419-20, the failure to include *any* provision for damage remedies in the Advisers Act is best explained by reasons of policy which Congress deemed sound, and which would actually be undermined by the implication of a private damage action.

The Advisers Act was passed in 1940, almost four decades ago. It was designed as a threshold attempt to effect a compulsory census of investment advisers, and not as a pervasive regulatory scheme. In all these years no litigant has urged to a Court of Appeals that Section 206 of the Act is a basis for a private damage action.[12] The majority opinion suggests that when the Act first became law in 1940, Congress gave no thought to the possibility of a private right of action against investment advisers, and finds this to be an argument in favor of implication, as we have seen. The court ignores the circum-

duty created" under the Act. The Court specifically referred to *Deckert* v. *Independence Shares Corp.*, 311 U.S. 282 (1940), which had emphasized the same language in Section 22(a) of the 1933 Act, 15 U.S.C. § 77v(a), "to enforce any liability or duty created by this subchapter." The *Deckert* Court added: "The power to enforce implies the power to make effective the right of recovery *afforded by the Act.*" 311 U.S. at 288. (Emphasis added).

12 The issue was tendered but not passed upon in *Brouck* v. *Managed Funds, Inc.*, 286 F.2d 901 (8th Cir. 1961), *vacated as moot*, 369 U.S. 424 (1962). In his monumental treatise, Professor Loss does not even mention the possibility of a private damage action under § 206. He does indicate that § 215(b) is "relevant" to the question of civil liability, but concludes that there has been "no significant litigation." *See* L. Loss, *Securities Regulation* 1757 (1961 ed.); *id.* at 3864-65 (Supp. 1969).

stance, however, that when Congress passed the 1970 amendments, Public Law No. 91-547, 84 Stat. 1413, it specifically addressed itself to the civil liability of investment advisers. When it did, it limited that liability (a) to investment advisers who advise *investment companies* and no others, and (b) only to the extent of a breach of fiduciary duty concerning compensation for services or like payments. Investment Company Act § 36, 15 U.S.C. § 80a-35. *See Galfand* v. *Chestnutt Corp.*, slip op. 409 (2d Cir. November 4, 1976). The implication is clear that Congress did give specific attention to investment advisers, but decided not to impose civil liability on those investment advisers who were not advisers to investment companies.

It is significant also, I think, that when Congress made a thoroughgoing revision of the Advisers Act in 1960, it failed to create a single express liability, nor did it amend Section 214 to include actions at law.[13] And in the 1970 amendments, Congress indicated that when it wanted to do so, it expanded the statutory relief available in the companion Investment Company Act, § 36, 15 U.S.C. § 80a-35, by providing that a court may "award such injunctive *or other relief.*" "Other relief" was added. *See Moses* v. *Burgin*, 445 F.2d 369, 373 n.7. In addition, the recently concluded Congress had before it an amendment proposed by the Securities and Exchange Commission

13 When Congress expanded the scope of the Act in 1960, it did not alter the statutory scheme. Instead, it strengthened the enforcement powers of the SEC, *see* S. Rep. No. 1760, 86th Cong., 2d Sess. 2, 4 (1960). Pub. L. No. 86-750, §§ 2-6, 74 Stat. 885, *amending* §§ 203-04, 15 U.S.C. § 80b-3, -4. Moreover, the *Commission* was given the power to obtain injunctive relief against aiders and abettors as well as principal violators. *Id.* at § 12. Section 206 itself was amended to apply to unregistered as well as registered advisers. *Id.* at § 8. Suffice it to say that Congress was aware of the problems of enforcement and that it dealt with the problem as it saw fit. It is not for the courts to decide that this remedial scheme is still insufficient.

providing for a private damage action under the Advisers Act. It does not appear seemly to me, unless we are under an absolute compulsion to do so, suddenly to create such a claim for relief by judicial legislation, without the ability to define the outer limits of such a claim.

Congress is uniquely able to set the limits of any civil action for damages. That this is so is emphasized by the majority opinion on this very appeal. It holds that the 10b-5 claim is without merit, yet on the *same* factual allegations it supports a § 206 claim. In so doing, it circumvents the sound policies behind the restrictions on 10b-5 claims.

Thus, for example, the 10b claim is held to have been properly dismissed because, as my brother Timbers tells us:

> "They [plaintiffs] say that they would have withdrawn from the firm in 1968 if defendants had not misrepresented the true nature of the firm's investment at that time. The short answer to this branch of plaintiff's argument is that the requirement of fraud in connection with the purchase or sale of a security is not satisfied by an allegation that plaintiffs were induced fraudulently *not* to sell their securities. *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 737-38 (1975)" page 6220 (emphasis in original).

I am not sure that *Blue Chip* is so limited in its application. I think that the underlying concern in *Blue Chip,* though standing was involved, was not the lack of a technical "purchase or sale," which ingenuity might have supplied, *see* 492 F.2d 136, but, perhaps, the sheer inability to disprove what a plaintiff says he *would have* done if he had but known the truth. This problem is as acute in suing investment advisers as in suing offerors, perhaps

even more acute in the former situation. There is a distinct danger that, by implying an open-ended private right of action, the court is giving the clients of investment advisers *carte blanche* to convert themselves from victims to defrauders. Judge Hufstedler said it well in her excellent dissenting opinion below in *Blue Chip Stamps,* 492 F.2d at 148:

> "The passive investor could always await market developments without any risk, claiming deception caused nonbuying if the value of the securities proved more promising than the offeror's glum predictions and deception caused nonselling if a rosier prospectus was followed by a market decline."

In this very case the plaintiffs received profits from the restricted letter stock and waited almost a full year until the market became unfavorable before seeking redemption of their shares.[14] They deliberately entered into a partnership that was going to operate in the most speculative of investment activities. They gave the general partners the power to invest in any kind of security, to sell short and cover both securities and commodities, to buy and sell options and to cover, to play the commodities market, to buy on margin, to lend money to partners without security, and to pledge partnership assets for loans. *See* note 1, *supra.* Even a babe in the woods would know that he was giving his money to the general partners for discretionary speculation. The purchase of unregistered stock, far from being unforeseeable, fits quite well into this plan. For, in a rising market, well-selected investment letter

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14 Between the end of 1969 and September 30, 1970, the New York Stock Exchange composite index fell over 10%; the Dow Jones industrial average fell over 5%. Even if the hedge fund had invested in the most conservative blue-chip portfolios, therefore, plaintiffs would have suffered losses for the period.

stock can prove profitable, and established investment bankers handle such securities on an "investment letter" basis. Given the purposes of the hedge fund and the broad powers vested in the general partners, it is hardly likely that the plaintiffs were interested in evaluating the portfolio themselves. Indeed, the plaintiffs never asked for a list of the securities held by the partnership.

The complaint does not allege self-dealing, conflict of interest, or conversion of assets, any of which would be actionable under § 10(b), if in connection with the purchase or sale of securities. *See, e.g., Bird* v. *Ferry,* 497 F.2d 112 (5th Cir. 1974) (conversion by salesman). To the contrary, it shows that defendants themselves invested their own money and the money of their families, and there is no allegation that they withdrew it. The plaintiffs prospered under this management for a considerable time when the market was good, reaping profits from the investment of unregistered securities—letter stock as well as other securities in the common portfolio. Having joined the partnership as early as 1965, they undoubtedly basked in the euphoria of the bull market described by Judge Friendly in *Levine* v. *Seilon, Inc.,* 439 F.2d 328, 335 (2d Cir. 1971). Conversely, however, when the market turned down, it turned down for all, including the defendants.[15]

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15 The majority opinion assumes that when plaintiffs discovered the "misrepresentation" they could wait until the following year to see how the market would go, because their redemption right was restricted to redemption at particular stated times. But with all respect that simply does not follow. When a person discovers that he has been defrauded, he may sue *at once* for rescission or damages, regardless of the contractual restriction. *See* Prosser on Torts § 105, at 689 (4th ed. 1971); Restatement [First] of Torts § 549 note *e* (1938). The contrary rule would substantially undermine congressional policy. As the court said in *Royal Air Properties, Inc.* v. *Smith,* 312 F.2d 210, 213-14 (9th Cir. 1962): "The purpose of the Securities Exchange Act is to protect the innocent investor, not one who loses his innocence and then waits to see how his investment turns out before he decides to invoke the provisions of the Act."

This practical consideration indicates to me, not, as it is suggested in the majority opinion, that the plaintiffs should not be given a chance to prove their case, *see* footnote 22a, but that, in the absence of a legislative determination of the policy questions involved, we are treading on dangerous ground in implying a priavte action under § 206 on the fact pattern alleged here, and ought instead to leave the issue to Congress. To create an analogue to Section 10(b) without the requirement that the "fraud" be "in connection with the purchase or sale" of a security hardly gives broad effect to the policy considerations so clearly expressed in the majority opinion of the Supreme Court in *Blue Chip Stamps* and in Mr. Justice Powell's concurring opinion, as well as Judge Hufstedler's dissent in the Court of Appeals. The majority specifies no limits to the civil liability under § 206 which it is in the process of creating over this dissent. Yet, it is simply extending 10b-5 by resort to a different statute. As the Court said in *Ernst & Ernst* v. *Hochfelder,* —— U.S. ——, 96 S. Ct. 1375, 1389 (1976), "We would be unwilling to bring about this result absent substantial support in the legislative history, and there is none." We do not know, if Congress creates an express private cause of action for damages under § 206, that it will not limit the right as it did with respect to § 10(b), by imposing a purchase or sale requirement, and perhaps also by defining the measure of damages and enacting a separate statute of limitations.[16]

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16 The SEC, for whose excellent work I have the highest admiration, has been rebuffed by the Supreme Court in its attempt to repeal the requirement of "in connection with the purchase or sale of a security." *See Blue Chip Stamps, supra,* 421 U.S. at 732. It has also been rebuffed by this court, *see Levine* v. *Seilon,* 439 F.2d 328, 329 (2d Cir. 1971). And in the *Blue Chip Stamps* case, Mr. Justice Powell commented that the SEC had "joined, surprisingly" in urging expansion of the statute. 421 U.S. at 759.

The Commission, in its *amicus* brief, argues for an implied civil right of action for damages, on the ground that "the claim asserted by plaintiffs herein is not one that would test the *outer limits* of the cause of action created by the antifraud provisions of the federal securities laws." (Emphasis added). But what *are* the limits to what is essentially a Rule 10b-5 action, if not the prerequisite that the claim relate to the "purchase or sale of a security"? Implying a claim for relief without limitation will encourage actions against investment advisers for poor judgment, disguised by pleadings subtly implying fraud and deceit. The unfounded allegation itself, contrary to the solicitude originally expressed by the SEC itself, will spell grief for the investment adviser, and the expense of defending the action will often compel settlement.[17] Each consideration is a policy ground that should be weighed. *See Blue Chip Stamps, SIPC,* and *Amtrak.* Indeed, in its early days the SEC itself was vitally concerned with these considerations militating against public disclosure.[18] This belies any in-

17 Mr. Justice Rehnquist in *Blue Chip Stamps,* 421 U.S. at 740, stated that it was a policy concern that "even a complaint which by objective standards has very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial so long as he may prevent the suit from being resolved against him by dismissal or summary judgment." And Mr. Justice Powell considered that "allowing this type of open-ended litigation would itself be an invitation to fraud." 421 U.S. at 761.

Similarly, in *Securities Investor Protection Corp.* v. *Barbour,* 421 U.S. 412 (1975), Mr. Justice Marshall noted that "except with respect to the solidest of houses, the mere filing of an action predicated upon allegations of financial insecurity might often prove fatal." 421 U.S. at 422. He added: "These consequences are too grave, and when unnecessary, too inimical to the purposes of the Act, for the Court to impute to Congress an intent to grant every member of the investing public control over their occurrence." *Id.* at 423.

18 How strikingly similar was the explanation by the SEC representative to the House of the provisions of § 210:

> "The only other provision of consequence is section 210, which in our opinion will have a very salutary effect. The investment counsels were a little concerned about the effect on their business if it got around that the Securities and Exchange Commission was conducting an investigation. In order to safeguard against this danger section 210(a) and (b) provide that there shall not be any disclosure of any investigation by the Securities and Exchange Commission until it has made up its mind that a public hearing is to be held. Then in order to safeguard them further, subsection (c), provides that the Commission can not ask these investment counsellors to disclose their clients, and what their investments are, except if there is some indication of wrongdoing. Thereafter, in connection with the investigation, they have to make the disclosure."

Hearings on H.R. 10065 before the Subcomm. of the House Comm. on Interstate and Foreign Commerce, 76th Cong., 3d Sess. 138 (1940); *see also Senate Hearings, supra,* at 713, 715.

tention by Congress to open wide private civil complaints which, in the nature of our adversary proceedings, become public property at once.

The blackmail effect of allowing customers to sue investment advisers for damages for what the customer might have done if he had but known, seems obvious for the reasons so well stated by Mr. Justice Marshall. The customer has ample relief under § 10(b), for misrepresentations made by the investment advisers in the process of getting him into the adviser's fund.[19] And if Congress wishes to go further, it can do so.

Since my brethren wish to create a new implied right of action, I have given my reasons for dissenting from their view. As indicated, I concur in the dismissal of the § 10(b) claim, but would carry over some of the reasoning to dismiss the asserted claim under § 206 as well.

19 The Commission in its *amicus* brief asserts that "this private action undeniably could be maintained [on the basis of § 10(b)] alone." This is contrary to our unanimous holding on this appeal. But we all agree that in proper circumstances, investment advisers are as liable as any other persons under § 10(b). *Cf. Superintendent of Insurance* v. *Bankers Life & Cas. Co.,* 404 U.S. 6 (1971); *Herzfeld* v. *Laventhol, Krekstein, Horwath & Horwath,* CCH Fed. Sec. L. Rptr. ¶ 95,660 (2d Cir., July 15, 1976); *Shapiro* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 495 F.2d 228 (2d Cir. 1974). This fortifies the argument that there is no need for an additional judicially created remedy against advisers where the purchase or sale of securities is involved.

Order on Petitions for Rehearing

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

75-7203

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the sixth day of January, one thousand nine hundred and seventy-eight.

Present:

HON. WALTER R. MANSFIELD,
HON. WILLIAM H. TIMBERS,
HON. MURRAY I. GURFEIN,
Circuit Judges.

ROBERT ABRAHAMSON and MARJORIE ABRAHAMSON,

Plaintiffs-Appellants,

v.

MALCOLM K. FLESCHNER, WILLIAM J. BECKER, HAROLD B. EHRLICH, LEON POMERANCE, FLESCHNER BECKER ASSOCIATES, and HARRY GOODKIN & COMPANY,

Defendants-Appellees.

Petitions for rehearing having been filed herein by counsel for appellees, pursuant to F.R.A.P. 40, addressed to this Court's panel opinions of February 25, 1977, – F.2d –, slip op. 6211; and

Order on Petitions for Rehearing

This Court by an order entered April 15, 1977 having granted the said petitions for rehearing to the extent of requesting the parties and the SEC to file further supplemental briefs on the issue of whether the general partners of defendant Fleschner Becker Associates are investment advisers within the meaning of the Investment Advisers Act of 1940 (the issue dealt with in section III(1) of the panel majority opinion of February 25, 1977, – F.2d at – - –, slip op. 6222-6226); and

This Court having granted leave to various interested persons to file amicus curiae briefs in connection with appellees' petitions for rehearing; and

This Court having received and considered the further supplemental briefs of the parties and of the SEC and the amicus curiae briefs, and having given due consideration to all claims raised on the petitions for rehearing and in the briefs referred to above; it is

ORDERED as follows:

(1) From the second sentence of the last paragraph of footnote 16 of the majority panel opinion, the last four words, i.e. "to the limited partners" are stricken, so that the sentence as revised will read:

> "The general partners as individuals, not FBA as an entity, were the investment advisers."

(2) In all other respects, the petitions for rehearing are denied and the panel opinions are adhered to.

/s/ WALTER R. MANSFIELD
Walter R. Mansfield

/s/ WILLIAM H. TIMBERS
William H. Timbers

[not signed]
Murray I. Gurfein
Circuit Judges

MEMORANDUM ON "ORDER ON PETITIONS FOR REHEARING"

1. Since I dissented from the majority opinion I do not participate in its correction.

2. Since I believe that the complaint should be dismissed, as stated in my dissenting opinion, on the ground that there is no claim for relief in money damages under the Advisers Act, I do not now reach the question of whether the defendants were or were not investment advisers. In view of the fact that the majority adhere to their order for a remand, I would prefer, on the basis of my study of the supplemental briefs, to rule on the question only after appropriate findings of fact by the District Court concerning who holds title to the assets; whether the general partners contributed their own money in substantial sums; the characteristics of the limited partners; whether there was any solicitation of the public; what advice, if any, was given to the limited partnership, and how it differs from "advice" given to any trust or partnership by a trustee or general partner when he buys or sells securities.

Since I am outvoted in any event on the remand, I join in the denial of the petitions for rehearing with the foregoing comment.

/s/ MURRAY I. GURFEIN
Circuit Judge

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the sixth day of January, one thousand nine hundred and seventy-eight.

ROBERT ABRAHAMSON and MARJORIE ABRAHAMSON,

Plaintiffs-Appellants,

v.

MALCOLM K. FLESCHNER, WILLIAM J. BECKER, HAROLD B. EHRLICH, LEON POMERANCE, FLESCHNER BECKER ASSOCIATES, and HARRY GOODKIN & COMPANY,

Defendants-Appellees.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for defendants-appellees, and no active judge or judge who was a member of the panel having requested that a vote be taken on said suggestion,

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

/s/ IRVING R. KAUFMAN
Irving R. Kaufman
Chief Judge

Order and Opinion of Judge Carter

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

71 CIV. 344

ROBERT ABRAHAMSON and MARJORIE ABRAHAMSON,

Plaintiffs,

—against—

MALCOLM K. FLESCHNER, WILLIAM J. BECKER, HAROLD B. EHRLICH, FLESCHNER BECKER ASSOCIATES, and HARRY GOODKIN & COMPANY,

Defendants.

APPEARANCES:

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Harry Goodkin & Company

CARTER, District Judge

Plaintiffs, Marjorie and Robert Abrahamson, are former limited partners of defendant Fleschner Becker Associates ("FBA"), an investment partnership. In addition to suing the limited partnership, plaintiffs also bring this action against three general partners of FBA and the firm of certified public accountants which audited the books of FBA for the fiscal years 1966, 1967, and 1968. Generally, the plaintiffs allege acts of securities fraud. Specifically, they assert violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and of Rule 10b-5 promulgated thereunder, and of Section 206 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6. Federal jurisdiction is based upon Section 27 of the 1934 Act, 15 U.S.C. § 78aa, and Section 214 of the Investment Advisers Act, 15 U.S.C. § 80b-14.

Plaintiffs' principal claim is that defendants concealed from them that an enormous percentage of FBA's portfolio consisted of unregistered or restricted securities.[1] Plaintiffs allege that in 1970 they withdrew from FBA as soon as they learned of FBA's disproportionate investment in unregistered securities, but claim they received far less than they would have received had they been informed of the truth earlier and withdrawn at the end of an earlier fiscal year. It is asserted that the concealment of the true facts concerning FBA's investments resulted in damages to them in excess of $1,000,000.

[1] "Restricted securities" are securities acquired directly or indirectly from an issuer or its affiliates in a transaction not involving a public offering. Absent registration, such securities are subject to restrictions regarding any later public sale. *See generally* SEC Securities Act Release No. 5223 (January 11, 1972).

BACKGROUND FACTS

The following facts are not in dispute. On or about July 1, 1965, plaintiffs became limited partners of FBA (then known as The Fleschner Co.) following several conversations with defendant Malcolm Fleschner in late 1964 and in 1965. In those conversations, plaintiffs expressed their concern for financial security and conservatism in investment; Fleschner, in turn, expressed his intent to create an investment partnership with a conservative investment policy.

FBA was started as a small partnership. By April, 1966, it grew to 35 limited partners, and by October, 1968, it had at least 66 limited partners. Defendant Fleschner, the person responsible for FBA's formation, was at all times a general partner of FBA. Defendant William Becker was a general partner at all times after April, 1966; and defendant Ehrlich was a general partner from October, 1968, to September, 1969. The defendant Harry Goodkin & Co. ("Goodkin") was the aforementioned firm of accountants. Year-end financial statements were certified by Goodkin and mailed to plaintiffs. Balance sheets were contained in the financial statements indicating FBA's investment in securities. The securities were not itemized in the statements for fiscal 1967 and 1968. The figure in the balance sheets showing FBA's securities investment was designated "market value." Goodkin sent drafts of the certified financial statements to the general partners of FBA for their review before it mailed them to the limited partners.

The general partners also mailed monthly reports to FBA's limited partners. Those reports were mostly concise, one-page statements setting forth the percentage increase or decrease in the value of FBA's investments for the year to

date and comparing this performance with the Standard & Poor's 500 Stock Average activity within the same period. The report also contained comments characterizing FBA's overall approach to investment opportunities as "low risk" or "conservative." [2]

During the period September, 1967, through September, 1968, FBA increased its investment in unregistered securities from approximately 15% to approximately 72% [3] of its portfolio. During this time the monthly reports sent to plaintiffs and all other limited partners uniformly described the company's "investment posture" as "most conservative."

Between September, 1968, and September, 1969, FBA's investment in unregistered securities fluctuated from about 72% to 88% of its portfolio. The monthly reports made no mention of the unregistered securities. In either December, 1969, or January, 1970, plaintiffs received the year-end financial statements for September, 1969, prepared by a new accounting firm, and a footnote to the statements revealed that approximately 77% of FBA's total investment in securities consisted of unregistered securities.

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[2] The following are some examples of those comments:

"We continue to maintain a low risk stance." (Report dated November 2, 1967);

"We remain in a most conservative posture." (Report dated December 1, 1967);

"We have maintained the previously mentioned low risk stance through the current market weakness." (Report dated February 2, 1968); and

"Our investment posture remains most conservative." (Report dated April 2, 1968).

Plaintiffs' Memorandum at 7-8.

[3] There really is no dispute concerning these figures. Defendants FBA, Fleschner and Becker merely contend that the percentage calculations should be based on the total value of FBA's invested assets, rather than limiting the denominator to investments in securities.

Allegedly learning of this fact for the first time, plaintiffs withdrew at the earliest possible time after receiving the 1969 statements, that is, September, 1970.

It is undisputed that the following figures represent the capital contributions, interim withdrawals and final distributive shares of the plaintiffs:

Robert Abrahamson

Date	*Capital Contributions*		*Withdrawals*
July 1, 1965	$150,000.00		
Sept. 30, 1967			$ 8,000.00
Sept. 30, 1968			32,500.00
Sept. 30, 1969			70,000.00
Sept. 30, 1970			45,500.00
Distributive share on withdrawal from the partnership			150,097.00
Totals	$150,000.00		$306,097.00
Net Profit		$156,097.00	

Marjorie Abrahamson

Date	*Capital Contributions*		*Withdrawals*
July 1, 1965	$180,000.00		
Oct. 1, 1966	2,652.22		
Sept. 30, 1967			$ 57,015.70
Oct. 1, 1967	266,847.13		
Sept. 30, 1968			58,000.00
Sept. 30, 1969			52,500.00
Sept. 30, 1970			73,500.00
Distributive share on withdrawal from the partnership			$341,565.00
Totals	$449,499.35		$582,580.70
Net Profit		$133,081.35	

Plaintiffs claim of damages in excess of $1,000,000 results from comparing what they actually received when they withdrew from FBA, and the amount they would have received if they had withdrawn as of the end of September, 1968. They assert that they would have withdrawn earlier but for defendants' failure to divulge the existence and extent of FBA's investment in unregistered securities and the omission of this information in the year-end and monthly reports mailed to them. They claim reliance on the statements, reports, and personal representations of Fleschner in retaining their investment in FBA until 1970.

Discussion

All defendants have moved for summary judgment pursuant to Rule 56, F.R.Civ.P., and all defendants have joined in the following contentions: 1) that plaintiffs have suffered no damages; 2) that the FBA agreement of limited partnership signed by plaintiffs authorized the purchase of securities of every kind; 3) that plaintiffs were entitled to inspect FBA's books and records and, therefore, are chargeable with constructive knowledge of the existence of FBA's investment in unregistered securities; 4) that defendants were not "investment advisers" within the meaning of the Investment Advisers Act of 1940. Additionally, defendant Goodkin claims that there were no material nondisclosures in connection with the purchase or sale of a security within the meaning of Rule 10b-5, and that Goodkin did not act in concert with the other defendants. Defendant Ehrlich contends that if any wrongdoing occurred, it did not take place while he was a general partner of FBA.

Plaintiffs have also moved for summary judgment. They assert: 1) that their withdrawal from FBA constituted a "sale" of a "security"; 2) that the alleged nondisclosure

occurred "in connection with" the purchase or sale of a security; 3) that the defendants' nondisclosure of FBA's investment in unregistered securities was a concealment of a material fact; and 4) that "causation" is presumed from the alleged materiality of the nondisclosure.

Defendants' motions for summary judgment must be granted. While summary judgment is not generally favored in this Circuit, and is sparingly granted in complicated securities cases, *see, e.g., Schoenbaum* v. *Firstbrook*, 405 F. 2d 215 (2d Cir. 1968) (*en banc*), *cert. denied*, 395 U.S. 906 (1969), this case presents a situation where summary judgment is appropriate. "The motion will be granted when it raises at least one legally sufficient defense that would bar a plaintiff's claim and involves no triable issue of fact." Wright & Miller, *Federal Practice and Procedure*, Civil § 2734, at 647-48 (3d Ed. 1973). Plaintiffs have suffered no damages and hence have failed to state a cause of action under the Securities and Exchange Act of 1934 or the Investment Advisers Act of 1940.

In granting defendants' motions, it is only necessary to consider the primary contention raised by all defendants, that the figures representing plaintiffs' contributions, withdrawals and distributive shares plainly show that plaintiffs have suffered no economic injury enabling them to succeed in an action for damages under Rule 10b-5 or Section 206. Plaintiffs concede that the total amounts received from FBA exceed their capital contributions. However, they urge three alternative arguments to support their contention that they are entitled to the difference between the amount they would have received if they had terminated their partnership interests in 1968, and the amount they actually received in 1970.

The first argument is that many of their interim FBA withdrawals were withdrawals of partnership income which

should not be counted in determining gain or loss upon liquidation of their interests. Secondly, it is argued that even if all withdrawals are counted in determining the amount received, with a net gain thereby resulting, case law requires awarding them damages in the sum claimed. Finally, they assert that a cause of action which may fail for want of damages under Rule 10b-5 does not necessarily fail under the Investment Advisers Act.

1. *The Nature of the Withdrawals*

In sum, plaintiffs submit that many of the interim withdrawals consisted of their share of partnership income, akin to the receipt of dividends on stock or of interest on bonds, such sums allegedly being immune from profit/loss calculations in a Rule 10b-5 suit. Because of this purported similarity, it is contended that certain withdrawals should be ignored in determining damages.[4] Defendants counter with a three-fold response: first, the limited partnership interests were not interest-bearing or dividend-paying, and any interim withdrawals were actually deductions from the Abrahamsons' capital accounts; second, the 1967 and 1968 financial statements for FBA reveal net ordinary losses, thereby refuting plaintiffs' claim of withdrawal of partnership *income;* and third, the characterization of the withdrawal is irrelevant in any event, for payments of any type received from a defendant must be taken into account in computing a plaintiff's damages.

It is unnecessary to decide the proper characterization of some or even all of the withdrawals, for all payments to

[4] Even if *all* the interim withdrawals are deducted, Robert Abrahamson would still have a net gain of $87.00. However, similar total deductions would leave Marjorie Abrahamson with a net loss of $107,834.35.

plaintiffs, be they considered dividends or interest, must be counted in determining the amount of actual loss that can be recovered in Section 10b litigation.

Few cases have arisen concerning the measure of damages in Rule 10b-5 actions, and none at all concerning the inclusion of interim withdrawals from a limited partnership; I am persuaded that in determining what damages, if any, plaintiffs have suffered, the inclusion of plaintiffs' withdrawals are required. In *Fershtman* v. *Schectman,* 450 F. 2d 1357 (2d Cir. 1971), *cert. denied,* 405 U.S. 1066 (1972), the court could find no damages where a hypothetical limited partner making an initial capital contribution of $10,001.00 would have been repaid $6,600 and would have been entitled to receive $13,426.75 in profits on his diminishing capital balance.

More particularly, the Tenth Circuit has held in a suit for damages under Rule 10b-5 that a buyer[5] "is entitled to recover any additional outlays attributable to the defendant's conduct *less dividends or any other payments* received from the defendant seller," *Richardson* v. *MacArthur,* 451 F. 2d 35, 44 n.13 (10th Cir. 1971), *quoting Esplin* v. *Hirschi,* 402 F. 2d 94, 105 (10th Cir. 1968), *cert. denied,* 394 U.S. 928 (1969); *cf. Fox* v. *Glickman Corp.,* 253 F. Supp. 1005 (S.D.N.Y. 1966) (dividends paid by corporation to plaintiff had to be included in the

[5] Plaintiffs have consistently maintained that the termination of their partnership interests was a "sale" of securities. However, they also argue that the execution of their 1968 partnership agreement can be viewed as a purchase of securities. Plaintiffs' Memorandum at 44. Consequently, there is no need to consider any possible difference regarding the measure of damages in a buyer's Rule 10b-5 suit versus a seller's suit, though there is little likelihood that any difference remains in this Circuit. *See* Zeller v. Bogue Electric Manufacturing Corp., 476 F. 2d 795 (2d Cir.), *cert. denied,* 414 U.S. 908 (1973).

damages determination, but the court characterized the dividends as a return of capital which was not taxable to the stockholders).

In *Richardson,* the plaintiff had to deduct all dividends and other payments which he received by virtue of possession of stock sold to him by the defrauding seller; the plaintiff also had to deduct all profit which was made in sales of the stock to other buyers. In *Schaefer* v. *First National Bank,* 326 F. Supp. 1186 (N.D. Ill. 1970), *appeal dismissed,* 465 F. 2d 234 (7th Cir. 1972), another buyer's action for damages under Rule 10b-5, named plaintiffs in a class action received consideration in return for an agreement not to execute a judgment against certain defendants. These payments were counted by the court in computing the named plaintiffs' damages. Because the inclusion of the payments resulted in no damages, the securities act count was dismissed. Finally, in *Twomey* v. *Mitchum, Jones & Templeton, Inc.,* 262 Cal. App. 2d 690, 69 Cal. Rptr. 222 (1968), in a suit brought by the plaintiff customer against the defendant brokerage firm, the court in computing the plaintiff's losses included dividends received and profits made from the sales of stock.

No case law has been discovered or cited which convinces the court that plaintiffs' interim withdrawals should not be counted in determining their gain or loss. In determining the extent of the 10b damages recoverable which is the difference between what they invested in FBA and what they received, the withdrawals must be considered. For Robert Abrahamson, his total withdrawals added to $306,097.00; when compared to his capital contributions, it is determined that Robert Abrahamson received $116,097.00 in profit. Marjorie Abrahamson's withdrawals totaled $582,580.70, giving her a profit of $133,081.35 over her capital contributions.

2. *The Measure of Damages in a 10b-5 Claim*

The plaintiffs' second argument for both the presence and awarding of damages is that even if withdrawals are counted and result in net gain, and no loss, the law is "plain" that they have suffered damages equal to the difference between what they received upon the termination of their investment in FBA and what they would have received had they terminated at the "appropriate time." The only thing "plain" is that plaintiffs have failed to state a cause of action [6] and have misstated the law.

While Rule 10b-5 litigation has increased dramatically in recent years, few cases have been decided on the merits. Consequently, the stage where damages are calculated has rarely been reached. *See* 3 Bromberg, *Securities Law: Fraud,* § 9.1, at 225 (1973); Jennings and Marsh, *Securities Regulation* 1186 (3d Ed. 1972); Cobine, *Elements of Liability and Actual Damages in Rule 10b-5 Actions,* 1972 Un. Ill. L. Forum 651. Nonetheless, a "traditional" damages award in 10b-5 actions has developed, and is based on Section 28(a) of the Securities Exchange Act of 1934. That Section reads in part that "no person . . . shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of." 15 U.S.C. § 78bb(a). While "actual damages" has been most often translated as

[6] It is assumed *arguendo* that plaintiffs' limited partnership interests were securities, and that their sale, or purchase, was a sale or purchase of securities for purposes of Rule 10b-5. Fershtman v. Schectman, 450 F. 1357 (2d Cir. 1971), *cert. denied,* 405 U.S. 1066 (1972); Sultan v. Bessemer-Birmingham Motel Associates, 322 F. Supp. 86 (S.D.N.Y. 1970); Lerman v. Tenney, 295 F. Supp. 780 (S.D.N.Y. 1969); Fox v. Prudent Resources Trust, [Current Binder], CCH Fed. Sec. L. Rep. ¶ 94,826 (E.D. Pa. 1974).

"out of pocket loss," Section 28(a) has been interpreted so as to allow a defrauded buyer to choose recission instead of the difference between the value of what he gave up and the value of what he received, and to allow a defrauded seller to recover any profits that the buyer has made on resale. *See Bromberg, supra,* at 226-27; *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128 (1972); *Zeller* v. *Bogue Electric Manufacturing Corp.,* 476 F. 2d 795 (2d Cir.), *cert. denied,* 414 U.S. 908 (1973).

The Fifth Circuit has stated in *Herpich* v. *Wallace,* 430 F. 2d 792, 810 (5th Cir. 1970):

> "The gist of the Rule 10b-5 action for damages is economic injury to the plaintiff resulting proximately from the acts of the defendants which constitute a violation of the rule."

See also Estate Counseling Service, Inc. v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 303 F. 2d 527, 533 (10th Cir. 1962); *Wittner* v. *Chop,* [1964-66 Transfer Binder], CCH Fed. Sec. L. Rep. ¶ 91,623 (S.D.N.Y. 1966); *Madigen, Inc.* v. *Goodman,* 357 F. Supp. 1331, 1333 (N.D. Ill. 1973), *rev'd on other grounds,* 498 F. 2d 233 (7th Cir. 1974).

A close reading of the cases relied upon by plaintiffs reveals no support for their claim that they are entitled to damages in a situation where no loss has been suffered and where a substantial gain has in fact been made. Initially, *Affiliated Ute, supra,* is not any authority for the proposition that plaintiffs are entitled to the difference between the fair value of what the seller received and what he would have received had there been no fraudulent conduct. *Affiliated Ute* did not abandon the "out of pocket loss" measure of 10b-5 damages. This yardstick was extended to award a plaintiff the defendant's profits resulting from

a fraudulent purchase *if* those profits *exceeded* the plaintiff's "out of pocket loss." *See Zeller* v. *Bogue Electric Manufacturing Corp., supra,* 476 F. 2d at 801; *Gerstle* v. *Gamble-Skogmo, Inc.,* 478 F. 2d 1281, 1304 (2d Cir. 1973). The District Court in *Affiliated Ute* had found that the white transfer agents had purchased the mixed-bloods' shares for less than fair value; the Supreme Court noted that "the defendants were in a position to gain financially from [the plaintiff's] sales." 406 U.S. at 153. The Court then stated that the measure of damages to be applied in that case was:

> "the difference between the fair value of all that the mixed-blood seller received and the fair value of what he would have received had there been no fraudulent conduct, . . . except for the situation where the defendant received more than the seller's actual loss. In the latter case damages are the amount of the defendant's profit." *Id.* at 155.

Plaintiffs also rely on the Tenth Circuit's opinion in *Mitchell* v. *Texas Gulf Sulphur Co.,* 446 F. 2d 90 (10th Cir.), *cert. denied,* 404 U.S. 1004 (1971). The damages awarded in *Mitchell* were the amount it would have taken a reasonable investor to *reinvest* in the TCS market within a reasonable time after he became aware of the true facts. Although this award was higher in fact than an "out of pocket" award would have been, the approach in *Mitchell* is not applicable in this case. The court was careful in *Mitchell* to warn that its computation of damages was not a uniform rule with broad application to all securities cases, *id.* at 105, and the Tenth Circuit has limited *Mitchell* to its facts. *See Richardson* v. *MacArthur, supra,* 451 F. 2d at 43-44. While *Mitchell* is in probable conflict with Section 28(a), *see The Measure of Damages in Rule 10b-5*

Cases Involving Actively Traded Securities, 26 Stan. L. Rev. 371, 379 (1974); 49 Texas L. Rev. 1141 (1971), the conflict need not be resolved since the case before us does not involve a reinvestment situation.

Plaintiffs also misread *Janigan* v. *Taylor,* 344 F. 2d 781 (1st Cir.), *cert. denied,* 382 U.S. 879 (1965). In *Janigan,* plaintiffs were former shareholders and corporate directors who had sold their shares to the former president of the company in reliance on the latter's representation concerning the future course of the corporation. The defendant purchased the shares for $40,000 and sold them two years later for $700,000. The court awarded his profit to the plaintiffs, stating:

> "It may, as in the case at bar, be entirely speculative whether, had plaintiffs not sold, the series of fortunate occurrences would have happened in the same way, and to their same profit. However, there can be no speculation but that the defendant actually made the profit and, once it is found that he acquired the property by fraud, that the profit was the proximate consequence of the fraud, whether forseeable or not. It is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them . . . it is simple equity that a wrongdoer should disgorge his fraudulent enrichment." *Id.* at 786.

To the same effect are *Myzel* v. *Fields,* 386 F. 2d 718 (8th Cir. 1967), *cert. denied,* 390 U.S. 951 (1968), and *Affiliated Ute, supra.* However, those cases can have little application here where there is no allegation of wrongful profit and in fact substantial agreement exists that the defendants have not been enriched as a result of their allegedly fraudulent conduct and have no profits to disgorge.

Plaintiffs' final reliance is placed on *Travis* v. *Anthes Imperial Ltd.,* 473 F. 2d 515 (8th Cir. 1973). In *Travis,* the Eighth Circuit held that plaintiffs had standing to sue defendants under Rule 10b-5 where the plaintiffs alleged that the defendants' misrepresentations encouraged them to hold their stock until the defendants controlled the market in that stock. The plaintiffs in that case claimed that they "would have sold their stock earlier when a market . . . existed and the price was higher." *Id.* at 521. The facts in *Travis* do not reasonably lead to the conclusion that the plaintiffs enjoyed a net gain, as here, before instituting suit. Moreover, *Travis* does not support the standards for awarding damages which plaintiffs assert are applicable. *Travis* has consistently been read as a purchaser-seller case following either *Vine* v. *Beneficial Finance Co.,* 374 F. 2d 627 (2d Cir.), *cert. denied,* 389 U.S. 970 (1967) ("forced seller" exception); or *Stockwell* v. *Reynolds & Co.,* 252 F. Supp. 215 (S.D.N.Y. 1965) ("aborted seller" exception). *See, e.g., Smallwood* v. *Pearl Brewing Co.,* 489 F. 2d 579, 593 (5th Cir. 1974); *Manor Drug Stores* v. *Blue Chip Stamps,* 492 F. 2d 136, 140 (9th Cir. 1973); *In re Penn Central Securities Litigation,* 367 F. Supp. 1158, 1173 (E.D. Penn. 1973); *Getter* v. *R. G. Dickinson & Co.,* 366 F. Supp. 559, 563-64 (S.D. Ia. 1973).

Based on my reading of the case law in this and in other circuits, I am confident that plaintiffs have suffered no actionable harm measurable in damages under Rule 10b-5. *Fershtman* v. *Schectman, supra,* involved a complaint alleging a variety of misrepresentations and nondisclosures in connection with a purchase of certain limited partnership interests and their subsequent "forced sale" upon the termination of the limited partnership. The court held that the facts did not give rise to a suit under Rule 10b-5

but rather supported a claim for reformation of the partnership agreement under state law. One ground on which the court relied for dismissing the complaint for want of jurisdiction was the absence of damages:

> "Beyond that the plaintiffs have suffered no damage from making their investments; rather they have reaped large profits." 450 F. 2d at 1361.

The Second Circuit's decision in *Levine* v. *Seilon, Inc.*, 439 F. 2d 328 (2d Cir. 1971), also seems to preclude the rule of damages which plaintiffs advance. That case involved a 10b-5 claim by a former preferred stockholder of defendant. The plaintiff had alleged that the corporate defendant falsely represented that it would honor a commitment to give preferred shareholders the opportunity to exchange their stock for common stock. The market price for preferred stock rose to reflect the future exchange. The corporation never made the exchange; instead it redeemed the preferred stock. Plaintiff claimed that he was misled into retaining his stock in anticipation of the exchange, arguing that he was damaged because he could have sold the shares on the market at a substantially higher price than the redemption acquisition price which he ultimately received. In affirming dismissal of the 10b-5 action, the court summarized the rule of damages in 10b-5 cases as follows: a defrauded buyer can recover only the excess of what he paid over the value of what he received; a defrauded seller is allowed to recover not only the difference between the actual value and what he received at the time of sale, but also any additional profits which the fraudulent buyer has actually realized or which the seller would have received had the seller held the stock for a reasonable time

after disclosure.[7] The court found that the defendant had obtained no "enrichment" and received no windfall as a result of the redemption. In fact, the stockholders received "a good deal more" than what the stock was worth:

> "The plain fact is that save for the possibility of selling to an innocent victim, Levine lost nothing from Seilon's alleged fraud except the euphoria he doubtless experienced during the summer and fall of 1968. This does not constitute the "actual damages," see § 28(a), compensable under § 10(b) of the Securities Exchange Act or Rule 10b-5." *Id.* at 335.

Like Seilon, FBA has obtained no enrichment, and, like Levine, the Abrahamsons have not been damaged.

Wolf v. *Frank*, 477 F. 2d 467 (5th Cir.), *cert. denied*, 414 U.S. 975 (1973), lends further support to defendants' motion. Plaintiffs purchased 37,500 shares in IGB Corporation for $73,000 in reliance on various representations made by defendants. Within six months of the purchase, plaintiffs had sold approximately 23,000 of their shares for $95,000. Plaintiffs sued the defendants individually and derivatively as stockholders of IGB, charging that the defendants had failed to fulfill their promises and alleging conduct generally violative of Rule 10b-5. The Court of Appeals agreed with the lower court's finding that the plaintiffs were not entitled to individual relief because they failed to show any actual damages, since they had made a profit of roughly $20,000, over and above the value of the IGB shares which had been retained.

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[7] Two years later the Second Circuit modified its statement in Levine and said that a defrauded buyer could also obtain, in addition to the usual measure of damages, windfall profits received by the defrauding party. *See* Zeller v. Bogue Electric Manufacturing Corp., *supra* n.5.

Moreover, a finding of profit is not even required to defeat an action for damages under Rule 10b-5; an absence of actual loss is sufficient. The District Court in *Lewis* v. *Bogin*, 337 F. Supp. 331 (S.D.N.Y. 1972), granted summary judgment for defendants on plaintiff's 10b-5 suit attacking a consummated merger. The merger was conceivably in violation of the securities laws. However, plaintiff suffered no damage, and hence had no valid 10b-5 claim, where his stock commanded the same price before and after the merger. The court in *Madigan, Inc.* v. *Goodman, supra,* similarly granted defendant's motion for summary judgment where plaintiff sold his stock for approximately the same amount at which it was acquired. Since plaintiff suffered no loss, he had no cause of action under Rule 10b-5. Because plaintiffs have failed to establish actual damages here, their 10b-5 claim is fatally defective.[8]

3. *The Measure of Damages in a § 206 Claim Under the Investment Advisers Act*

Plaintiffs' final point is that any "out of pocket" limitation on a private suit under Rule 10b-5 is inappropriate in a damages action pursuant to Section 206 of the Investment Advisers Act of 1940. The principal basis for this argument appears to be the absence in the Act of any provision

[8] The only case remotely *contra* is Stevens v. Abbott, Proctor & Paine, 288 F. Supp. 836 (E.D. Va. 1968), where the court rejected the "out of pocket" rule as an appropriate measure of damages in a 10b-5 case alleging excessive churning. Net profit would not be an absolute defense to such an allegation when a court might reasonably award a plaintiff the commission charged by and paid to the broker defendant. In effect, such a defendant would be forced to disgorge profits resulting from fraudulent conduct violative of Section 10b. As discussed earlier, there has been no allegation of defendants' enrichment due to the nondisclosure.

similar to Section 28(a) of the 1934 Act. No other authority is cited for this proposition.

While the rule requiring actual damages in 10b-5 actions is not necessarily applicable to every situation involving the securities laws, *see, e.g., Voege* v. *Ackerman*, 364 F. Supp. 72 (S.D.N.Y. 1973) (where proxies necessary for approval of merger were obtained in a materially misleading manner, the District Court might order an accounting to insure that the shareholders received the value that was represented as coming to them); *Stevens* v. *Abbott, Proctor & Paine*, 288 F. Supp. 836 (E.D. Va. 1968), the few cases arising under the Investment Advisers Act do not suggest that the rule under Section 206, the anti-fraud provision, is any different. *See Bolger* v. *Laventhol, Krekstein, Horwath & Horwath*, [Current Binder], CCH Fed. Sec. L. Rep. ¶ 94,739 (S.D.N.Y. 1974); *Courtland* v. *Walston & Co., Inc.*, 340 F. Supp. 1076 (S.D.N.Y. 1972); *Wiesenberger* v. *W. E. Hutton & Co.*, 35 F.R.D. 556 (S.D.N.Y. 1964). These three cases involved alleged violations of both Section 206 and Rule 10b-5, and the *Bolger* and *Courtland* courts noted the obvious similarity between the language of the Section and the Rule, CCH Fed. Sec. L. Rep. ¶ 94,739 at 96,456; 340 F. Supp. at 1083, a point with which plaintiffs are in express agreement. Plaintiffs' Reply Memorandum at 17. The *Courtland* decision also held at 1093 that an adequate measure of damages would be one "based on the monetary loss actually and proximately resulting from the acts complained of", language virtually identical to the words used in Section 28(a) of the Securities Exchange Act.

Finally, such an inconsistency between Rule 10b-5 and Section 206 would create an "unfortunate dichotomy" between the acts, *see Globus* v. *Law Research Service, Inc.*,

418 F. 2d 1276 (2d Cir. 1969), *cert. denied,* 397 U.S. 913 (1970); *Bolger, supra,* and no authority or persuasive rationale warrants reaching for such a conclusion.

In sum, as plaintiffs having shown no damages compensable under law, summary judgment is granted to all defendants.

So Ordered.

Dated: New York, New York
March 4, 1975

Robert L. Carter
U.S.D.J.

Interim Opinion of Court of Appeals

UNITED STATES COURT OF APPEALS

For the Second Circuit

No. 212—September Term, 1975.

(Argued October 16, 1975 Decided November 21, 1975.)

Docket No. 75-7203

Robert Abrahamson and Marjorie Abrahamson,

Plaintiffs-Appellants,

v.

Malcolm K. Fleschner, William J. Becker, Harold B. Ehrlich, Leon Pomerance, Fleschner Becker Associates, and Harry Goodkin & Company,

Defendants-Appellees.

Before:

Mansfield, Timbers and Gurfein,

Circuit Judges.

Appeal from judgment entered in the Southern District of New York, Robert L. Carter, *District Judge,* dismissing complaint, on cross-motions for summary judgment, in action to recover damages for alleged violations of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 promulgated thereunder, and Section 206 of the Investment Advisers Act of 1940.

Decision reserved on all issues pending filing of Supplemental briefs by the parties and an amicus curiae brief by the SEC on the issues raised under the Investment Advisers Act.

RONALD H. ALENSTEIN, New York, N.Y. (Kenneth A. Barry, and Shea Gould Climenko Kramer & Casey, New York, N.Y., on the brief, *for Plaintiffs-Appellants.*

RICHARD E. CARLTON, New York, N.Y. (Robert D. Owen, and Sullivan & Cromwell, New York, N.Y., on the brief), *for Defendants-Appellees Malcolm K. Fleschner, William J. Becker and Fleschner Becker Associates.*

RICHARD G. MCGAHREN, New York, N.Y. (Kenneth A. Sagat, and D'Amato, Costello & Shea, New York, N.Y., on the brief), *for Defendant-Appellee Harry Goodkin & Company.*

MARK M. JAFFE, New York, N.Y. (Allan J. Berdon, and Hill, Betts & Nash, New York, N.Y., on the brief), *for Defendant-Appellee Harold B. Ehrlich.*

PER CURIAM:

Plaintiffs Robert Abrahamson and Marjorie Abrahamson are former limited partners of defendant Fleschner Becker Associates (FBA), an investment partnership. Defendants Malcolm K. Fleschner and William J. Becker are general partners of FBA. Defendant Harold B. Ehrlich was a general partner of FBA during part of the relevant period. Defendant Harry Goodkin & Company is a firm of certified public accountants which audited FBA's books for the fiscal years 1966, 1967 and 1968.

Plaintiffs commenced an action in the Southern District of New York on January 25, 1971, alleging (A) violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b) (1970), and of Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1975); and (B) violations of Section 206 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6 (1970). Jurisdiction was based on Section 27 of the 1934 Act, 15 U.S.C. § 78aa (1970), and Section 214 of the Advisers Act, 15 U.S.C. § 80b-14 (1970).

The gravamen of plaintiffs' complaint is that, despite plaintiffs' and defendants' understanding that FBA would adhere to a conservative, liquid investment format, defendants concealed from them the fact that a large proportion of the FBA portfolio consisted of securities which were not registered with the Securities and Exchange Commission and which were subject to restrictions as to sale. Plaintiffs claim that in 1970 when they withdrew from FBA, upon learning of FBA's disproportionate investment in unregistered and restricted securities, they received substantially less than they would have received had they been informed of the truth earlier and had withdrawn at the end of an earlier fiscal year. Plaintiffs claim that concealment of the true facts concerning FBA's portfolio caused them damages in excess of $1,000,000.

Both sides moved for summary judgment. In an opinion dated March 4, 1975, Judge Carter granted defendants' motions for summary judgment and dismissed the complaint. Plaintiffs' motion for summary judgment was denied. From the judgment entered accordingly on March 27, 1975, plaintiffs have appealed.

Without reaching the merits of plaintiffs' claims under either the Advisers Act or the 1934 Act, the thrust of

Judge Carter's decision was that, since plaintiffs had realized a net profit on their overall limited partnership investment, they had failed to prove damages compensable under the federal securities laws.

After consideration of the briefs and oral arguments of the parties on the issues presented on this appeal, we have concluded that further briefs are necessary on the issues raised under the Advisers Act before we properly can decide this appeal. Without intimating any views on any of the issues in the case, therefore, we request that counsel for all parties file, within 30 days of the date of this opinion, supplemental briefs on the issues raised under the Advisers Act, including whether there exists a private right of action under that Act. So far as we are aware, this issue has not been decided to date by any federal appellate court, although it has been the subject of at least two decisions in the Southern District of New York. See *Bolger* v. *Laventhal Krekstein Horwath & Horwath*, CCH Fed. Sec. L. Rep. ¶ 94,618 (S.D.N.Y. 1974); *Jones* v. *Equitable Life Assurance Society*, CCH Fed. Sec. L. Rep. ¶ 94,986 (S.D.N.Y. 1975). We hope that the supplemental briefs may shed some light on the legislative history of the Advisers Act and particularly the reason, if any, that Congress used different phraseology in Section 214 of the Advisers Act than in the corresponding jurisdictional provisions of the other federal securities laws.

In view of what we regard as the importance and novelty of the issues under the Advisers Act upon which we have requested supplemental briefs from the parties, we also invite the Securities and Exchange Commission to file an amicus curiae brief on those issues within the time specified for the supplemental briefs from the parties.

Decision reserved on all issues pending filing of supplemental briefs by the parties and an amicus curiae brief by the SEC.

Order of Court of Appeals Granting Partial Rehearing

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

75-7203

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the fifteenth day of April, one thousand nine hundred and seventy-seven.

Present:

HON. WALTER R. MANSFIELD,
HON. WILLIAM H. TIMBERS,
HON. MURRAY I. GURFEIN,

Circuit Judges.

ROBERT ABRAHAMSON and MARJORIE ABRAHAMSON,

Plaintiffs-Appellants,

v.

MALCOLM K. FLESCHNER, WILLIAM J. BECKER, HAROLD B. EHRLICH, LEON POMERANCE, FLESCHNER BECKER ASSOCIATES, and HARRY GOODKIN & COMPANY,

Defendants-Appellees.

Petitions for rehearing having been filed herein by counsel for the defendants-appellees pursuant to F.R.A.P. 40

Upon consideration thereof, it is

Order of Court of Appeals Granting Partial Rehearing

Ordered that said petition be and it hereby is granted to the extent that the parties and the Securities and Exchange Commission are requested to furnish the court with a more thorough briefing on the issuue of whether the general partners of defendant Fleschner Becker Associates are investment advisers within the meaning of the Investment Advisers Act of 1940, which was considered only briefly in the amicus brief of the Securities and Exchange Commission filed February 2, 1976 (pages 9-12) and more extensively in the recent briefs filed by the defendants-appellees and amici curiae in support of the petition for rehearing.

In view of the fact that this appeal has now been pending for a long period of time, the appellants and the Securities and Exchange Commission are requested to file briefs on this limited issue on or before May 6, 1977. The defendants-appellees and amici are directed to file answering briefs on or before May 13, 1977. No extension of time will be granted for the filing of briefs on this issue.

/s/ WALTER R. MANSFIELD
Walter R. Mansfield

/s/ WILLIAM H. TIMBERS
William H. Timbers
(per WRM)

/s/ MURRAY I. GURFEIN
Murray I. Gurfein
(per WRM)
Circuit Judges

IN THE

Supreme Court of the United States

October Term, 1977

Nos. 77-1279
77-1314

MALCOLM K. FLESCHNER, WILLIAM J. BECKER, HAROLD B. EHRLICH, FLESCHNER BECKER, ASSOCIATES, and HARRY GOODKIN & COMPANY,

Petitioners,

v.

ROBERT ABRAHAMSON and MARJORIE ABRAHAMSON,

Respondents.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

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Of Counsel

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BRIEF FOR RESPONDENTS IN OPPOSITION

Opinions Below

The opinion of the District Court (Pet. App. 54-74)* is reported at 392 F. Supp. 740.

An interim opinion of the Court of Appeals (Pet. App. 75-78), reserving decision pending filing of supplemental briefs by the parties and an amicus curiae brief by the SEC, is reported at 537 F.2d 27.

* Throughout this brief the Petition and Appendices attached thereto of petitioners Fleschner, Becker, Fleschner Becker Associates and Ehrlich are referred to as "Pet. —" and "Pet. App. —", respectively. The separately filed Petition of Harry Goodkin & Co. is referred to as "Goodkin Pet. —".

The principal opinion of the Court of Appeals (Pet. App. 3-49) has not yet been officially reported; it is unofficially reported at CCH Fed. Sec. L. Rep. (1976-1977) Transfer Binder ¶ 95,889. This opinion was modified by an order of the Court of Appeals (Pet. App. 50-52), which also has not yet been officially reported.

Jurisdiction

The jurisdictional requisites are adequately set forth in the Petition at p. 2 and in the Goodkin Petition at p. 2.

Question Presented

Did the Court of Appeals correctly hold that respondents are entitled to a trial upon their complaint for damages under the Investment Advisers Act of 1940, naming the managing partners of an investment partnership as defendants as well as the accountant for the partnership, where the Act's legislative history and remedial purposes, and the history of decisional authority finding private rights of action under the federal securities laws, plainly support such a private right of action against an investment adviser and those who aid and abet him; where damages from the investment client's actual reliance on the intentional and material misrepresentations of the advisers and accountant are alleged; and where it is alleged that the accountant acted in concert with the advisers, having actual knowledge of the advisers' fraud?

Statutes

The pertinent provisions of the Investment Advisers Act of 1940, Section 206 (54 Stat. 852, as amended, 74 Stat. 887, 15 U.S.C. § 80b-6) and Section 214 (54 Stat. 856, 15 U.S.C. § 80b-14) are set forth in Petitioners' Appendix at pages 1-2.

Statement of the Case

In their complaint respondents alleged violations of Section 206 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6 ("Advisers Act"), and of Rule 10b-5 under the Securities Exchange Act of 1934 ("1934 Act"), arising out of their investment in limited partnership interests in an investment partnership. The principal impropriety alleged was that petitioners had concealed the fact that the partnership had made very substantial investments in unregistered securities. The Court below found that between September 1968 and September 1969, the "firm's investments in unregistered securities fluctuated from about 72% to 88% of its portfolio," although the reports to limited partners continued "not to disclose" these facts (Pet. App. 9).

The District Court, deciding motions by both sides for summary judgment, dismissed the complaint on the ground that respondents suffered no damages (Pet. App. 65-74).

On appeal, the Court of Appeals affirmed as to dismissal of respondents' claim under Rule 10b-5, but reversed, Gurfein, J., dissenting, the dismissal of the Advisers Act claim and remanded for trial. The only claim before this Court is the claim under the Advisers Act.

In reversing, the Court of Appeals held only that there is an implied private right of action under Section 206 of the Advisers Act and that respondents had alleged a claim for damages compensable thereunder (Pet. App. 14-32). The Court carefully withheld any comment as to whether respondents sustained any damages and, if so, how much, but did provide guidance on the proper measure of damages to be employed by the District Court upon remand (Pet. App. 32-33).

The Court below first considered the threshold question of whether any of the general partners of the investment partnership are "investment advisers" within the meaning of Section 202(a)(11) (Pet. App. 14). The Court of Appeals first found that they received compensation for their investment services, and then held, on two independent grounds, that they were "engage[d] in the business of advising others" with respect to investments (Pet. App. 15-18).

Having determined that the general partners of the investment partnership are investment advisers, the Court of Appeals then considered the question of whether a private right of action is to be implied under Section 206 of the Advisers Act. The Second Circuit noted that private rights of action are properly implied in favor of the intended beneficiaries of a statute where necessary to implement the statute's underlying purposes (Pet. App. 20). The Court further observed:

> "There are compelling reasons why the courts have been particularly willing to recognize private rights of action under the antifraud provisions of the federal securities laws. Those provisions are designed to protect specific classes of injured parties. Moreover, the SEC—the agency charged with administration and enforcement of the federal securities laws—does not have sufficient resources alone to enforce the many provisions of the statutes. Absent judicial recognition of private rights of action, the federal securities laws most assuredly would fail to provide the effective regulation over the securities industry which Congress intended." (Pet. App. 20).

For these reasons, the Court said, an implied right of action has been recognized by the courts of appeals under the Investment Companies Act—the legislative companion to

the Advisers Act—as well as under Sections 10(b) and 14 of the 1934 Act and under the Public Utility Holding Company Act of 1935 (Pet. App. 21).

The Second Circuit then considered the circumstances presented here against the factors suggested by the Supreme Court in *Cort* v. *Ash,* 422 U.S. 66, 78 (1975) (Pet. App. 21-22):

> (i) Is the plaintiff one of the class for whose especial benefit the statute was enacted?
>
> (ii) Is there any indication, explicit or implicit, that the Congress intended either to create such a remedy or deny one?
>
> (iii) Is it consistent with the underlying purposes of the legislative scheme to recognize such a remedy for the plaintiff?
>
> (iv) Is the cause of action one traditionally relegated to state law, so that it would be inappropriate to infer a cause of action based solely on federal law?

The Court of Appeals held:

> "We believe that each of these factors point unmistakably toward recognition of an implied right of action under Section 206 of the Advisers Act. See *Piper* v. *Chris Craft Industries, Inc.,* U.S. , 45 U.S.L.W. 4182, 4192-93 (U.S. Sup. Ct. Feb. 22, 1977)." (Pet. App. 22).

The Second Circuit first determined the class for whose benefit the Advisers Act was enacted.

> "The purpose of the Advisers Act was 'to protect the public and investors against malpractice by persons paid for advising others about securities.' The Act was designed for the 'especial' benefit of persons relying upon their investment advisers for advice.

SEC v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 186-91 (1963)." (Pet. App. 22).

The Court then concluded that it would not be inappropriate to infer a cause of action here based solely on federal law.

> "Congress enacted the Advisers Act, as it had earlier securities legislation, mindful of the need for *federal* regulation of the securities industry." (Pet. App. 22; emphasis in original).

The Court of Appeals could find no indication that Congress considered the question of private actions when it enacted the Advisers Act nor any indication that the SEC did so when it adopted Rule 206(4)-1 (Pet. App. 23). Ultimately, therefore, the question is whether the implication of such a remedy would be consistent with the underlying legislative purposes:

> "As stated above, the courts consistently have recognized that the Commission's resources are inadequate to the task of policing alone the federal securities laws. In enacting the 1940 legislation, Congress intended to provide effective *federal* regulation of an important segment of the securities industry. Failure to recognize a private right of action under the Advisers Act would effectively frustrate that purpose." (Pet. App. 23; emphasis in original).

The Court therefore reached the logical conclusion:

> "The Supreme Court, in considering a different issue under the Advisers Act in *SEC* v. *Capital Gains Research Bureau, Inc., supra,* 375 U.S. at 195, emphasized that the Act should 'be construed like other securities legislation "enacted for the purpose of avoiding frauds," not technically and restrictively, but flexibly to effectuate its remedial purposes.' (footnote omitted). We find that particularly cogent here where we are asked to determine whether there should be a private right of action to recover damages for what may be clear violations of the Act. Moreover, mindful of the Supreme Court's admonition in *J. I. Case* v. *Borak, supra,* 377 U.S. at 433, we believe that we should provide 'such remedies as are necessary to make effective the congressional purpose', rather than adopt a construction that would effectively defeat the purpose of providing federal regulation over an important segment of the securities industry.
>
> "We hold that there is an implied private right of action under Section 206 of the Advisers Act." (Pet. App. 27; footnote omitted).

Finally, the Court of Appeals considered the question of damages. It rejected petitioners' arguments that respondents' damage claims are too speculative as "clearly inconsistent with the intent of Congress" (Pet. App. 30) and found petitioners' reliance on *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), misplaced. The Court noted in this regard:

> "The *Blue Chip* decision was based on the *express language* of Section 10(b) and Rule 10(b)-5 requiring a fraud 'in connection with the purchase or sale of any security'. *Neither Section 206 of the Advisers Act nor Rule 206(4)-1 contains any such requirement.*" (Pet. App. 29-30; emphasis in original; footnote omitted).

Having found the respondents' alleged damages compensable under the Advisers Act, the Court discussed the proper measure thereof and found:

> "The proper measure of damages then would be that part of net losses incurred on unregistered securities after the point when the defendants' repre-

sentations became fraudulent which stems from the portion of those investments inconsistent with defendants' representations." (Pet. App. 33).

Reasons for Denying the Writ

I

The decision of the Court below is the reasoned and inevitable product of more than forty years' experience with the federal securities laws. Although, as the Court of Appeals noted in its interim opinion of November 21, 1975, no federal appellate court had yet decided whether a private right of action exists under the Advisers Act (Pet. App. 78), implied private rights of action had been found under all of the other major federal securities laws; the Second Circuit was the first appellate court to find an implied private right of action under the Advisers Act only because it was the first to rule on the subject. There is nothing startling about its reasoning. The decision below was entirely consistent with a long line of cases finding implied private remedies under the federal securities laws.*

* The Second Circuit first stated why there have been so many such decisions under the securities laws (Pet. App. 20):

> "There are compelling reasons why the courts have been particularly willing to recognize private rights of action under the antifraud provisions of the federal securities laws. Those provisions are designed to protect specific classes of injured parties. Moreover the SEC—the agency charged with administration and enforcement of the federal securities laws—does not have sufficient resources alone to enforce the many provisions of the statutes. Absent judicial recognition of private rights of action, the federal securities laws most assuredly would fail to provide the effective regulation over the securities industry which Congress intended."

The Court then collected some of the major decisions (Pet. App. 21):

(footnote continued on following page)

Since the decision below, the same issue has been presented to the Fifth Circuit in *Wilson* v. *First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978).* In its opinion, the Fifth Circuit declined the opportunity to create a conflict between the Circuits and ruled, Hill, J., dissenting, that there is an implied private right of action under the

(footnote continued from preceding page)

> "Applying these principles, the courts of appeals consistently have recognized an implied right of action under the Investment Companies Act—the companion to the Advisers Act. *Moses* v. *Burgin,* 445 F.2d 369 (1 Cir.), *cert. denied,* 404 U.S. 994 (1971); *Herpich* v. *Wallace,* 430 F.2d 792, 815 (5 Cir. 1970); *Esplin* v. *Hirschi,* 402 F.2d 94, 103 (10 Cir. 1968), *cert. denied,* 394 U.S. 928 (1969); *Taussig* v. *Wellington Fund, Inc.,* 313 F.2d 472, 476 (3 Cir.), *cert. denied,* 374 U.S. 806 (1963); *Brown* v. *Bullock,* 194 F.Supp. 207 (S.D. N.Y.), *aff'd,* 294 F.2d 415, 420-21 (2 Cir. 1961) (en banc). It is well settled that implied rights of action exist under Section 10(b) of the 1934 Act and Rule 10b-5, which contain substantially the same language as Section 206 of the Advisers Act. *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 730 (1975); *Superintendent of Insurance* v. *Bankers Life & Casualty Co., supra,* 404 U.S. at 13 n.9; *Fischman* v. *Raytheon Mfg. Co.,* 188 F.2d 783, 787 (2 Cir. 1951); *Kardon* v. *National Gypsum Co.,* 69 F.Supp. 512 (E.D. Pa. 1946). Judicially implied rights of action also have been found under Section 14(a) of the 1934 Act, *J.I. Case Co.* v. *Borak, supra,* and under the Public Utility Holding Company Act of 1935, *Goldstein* v. *Groesbeck,* 142 F.2d 422 (2 Cir.), *cert. denied,* 323 U.S. 737 (1944)."

* District Court decisions dealing with the question are collected in the Petition (p. 8, n.8). We think it is fair to say that the few cited decisions denying a private remedy are distressingly brief, and contain very little in the way of exposition, reasoning or consideration of authorities. The opposite is true of the decisions recognizing the right of action. We note that one case, *Gammage* v. *Roberts, Scott & Co.* 1974-75 CCH Fed. Sec. L. Rep. Transfer Binder ¶ 94,761 (S.D. Cal., 1974), is incorrectly cited by petitioners. We also note that they have omitted reference to a case in which a private right of action was recognized: *Jones* v. *Equitable Life Assurance Society,* 409 F.Supp. 370 (S.D.N.Y. 1975). Commentators who have reviewed the District Court decisions have agreed that a private right of action should be recognized. See the decision below (Pet. App. 19, n.17).

Advisers Act. In *Wilson*, the Court, citing the decision of the Second Circuit in the case at bar, rejected the very arguments raised by petitioners both below and in the instant petition.

Petitioners now ask this Court to review a decision which is thoroughly logical in its reasoning and its application of principles announced by this Court.* The petition presents no important question of federal law as to which there is any serious doubt, and there is no conflict of decisions among the courts of appeals. Accordingly, there is no reason for further review of this case by this Court.

Petitioners, we believe, have seriously distorted the decision of the Court below and have raised *in terrorem* arguments of no consequence. Each of their points is discussed below.

II

Petitioners' principal argument against an implied private right of action relies on the omission of three words from the jurisdiction and venue provisions of Section 214 of the Advisers Act, 15 U.S.C. § 80b-14. Section 214 provides that the district courts shall have jurisdiction "of all suits in equity to enjoin any violation of this subchapter." The language of Section 214 is similar to, but not quite the

* The Court below observed (Pet. App. 20),

"The Supreme Court has recognized in a variety of contexts that private rights of action may be implied in favor of the intended beneficiaries of a statute where necessary to implement the statute's underlying purposes. *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971); *J.I. Case Co.* v. *Borak*, 377 U.S. 426 (1964); *Tunstall* v. *Brotherhood of Locomotive Firemen and Enginemen*, 323 U.S. 210 (1944); *Texas & Pacific R.R.* v. *Rigsby*, 241 U.S. 33 (1916). Cf. *Bivens* v. *Six Unknown Narcotics Agents*, 403 U.S. 388 (1971); *Bell* v. *Hood*, 327 U.S. 678 (1946)."

same as, the language of the jurisdictional sections of other federal securities laws. The jurisdictional provisions of the Securities Act of 1933 (15 U.S.C. § 77v), the Securities Exchange Act of 1934 (15 U.S.C. § 78aa), the Public Utility Holding Company Act of 1935 (15 U.S.C. § 79y), and the Investment Company Act of 1940 (15 U.S.C. § 80a-43) all refer not only to suits in equity, but also to "actions at law brought to enforce any liability or duty" created by these statutes. Petitioners' argument is that the omission of the words "actions at law" limits the jurisdiction of the federal courts under § 206 to criminal prosecutions and SEC enforcement proceedings.

However, ordinary statutory construction supports respondents' position herein. The other securities laws referred to above contain provisions which *expressly* create private rights of action under certain sections, although not under others. For example, private rights of action are expressly created under Sections 11 and 12 of the Securities Act; under Sections 9(e), 16(b) and 18 of the Securities Exchange Act; under Sections 16(a) and 17(b) of the Public Utility Holding Company Act; and under Section 30(f) of the Investment Company Act. Because those statutes expressly create private rights of action, the inclusion in their jurisdictional sections of references to "actions at law" is entirely understandable.

The Advisers Act, however, created no *express* rights of action. For this reason a reference to such actions was unnecessary and its omission is entirely consistent with careful draftsmanship. This is precisely the interpretation adopted by the Second Circuit below:

> "In our view, the reason for this omission is that each of the other Acts whose jurisdictional provisions refer to 'actions at law' contains one or more sections *expressly* granting injured parties a private

> right of action for damages. There is no provision in the Advisers Act which *expressly* provides for private actions; since it is a less complex statute, containing no express grants of right of action to private parties, a reference to 'actions at law' would be superfluous." (Pet. App. 25; emphasis in original).

Accord, *Bolger* v. *Laventhol, Krekstein, Horwath & Horwath,* 381 F.Supp. 260, 264-65 (S.D.N.Y. 1974).

Although petitioners suggest elaborate explanations for the language of Section 214, nothing in the legislative history* supports their position.

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* The Investment Advisers Act, in the form in which it was originally introduced, provided that the jurisdictional provision of the Investment Company Act should be "incorporated in this title as though fully set forth therein." S. 3580, Section 203, 76th Cong., 3d Sess. The jurisdictional section of the Investment Company Act had been copied verbatim from the Public Utility Holding Company Act. S. 3580, Section 40(a), 76th Cong., 3d Sess. The companion bill introduced in the House of Representatives at the same time contained identical jurisdictional provisions. H. R. 8935, Sections 49(a), 203, 76th Cong., 3d Sess.

The Senate bill, when it was reported out of committee, had been amended to eliminate the incorporation by reference of the jurisdictional provisions of other statutes. The jurisdictional provision in the Advisers Act was instead spelled out, and contained no reference to actions at law to enforce liabilities created by that Act. But the committee report contains no comment upon the absence of such language, and certainly contains no indication that the deletion of references to actions at law was to prevent the implication of private rights of action.

In fact, the only comment in the Senate committee report dealing with the jurisdictional provisions of the Investment Company Act and the Investment Advisers Act demonstrates that no significant difference between those provisions was intended. The report discussed the provisions dealing with "unlawful representations, administration and enforcement machinery and formal provisions" as a group. In its discussion of such provisions as they appeared in the Advisers Act, the report stated that the Advisers Act "contains provisions generally comparable to those of" the Investment Company Act. S. Rep. 1775, 76th Cong., 3d Sess., p. 23.

(footnote continued on following page)

The Second Circuit, considering in the opinion below the same suggested explanations in even greater detail, concluded:

> "There is not a shred of evidence in the legislative history of the Advisers Act to support the assertion that Congress intentionally omitted the reference to 'actions at law' in order to preclude private actions by investors. Section 214, like the jurisdictional provisions of the other securities acts, was drawn to provide jurisdiction over actions expressly authorized by the statute. Far from indicating that Congress ever considered the matter of private actions in drafting Section 214, the only legislative history indicates that Congress attached no great importance to its omission. In their only references to Section 214, both the Senate and House Reports stated that the enforcement provisions of the Advisers Act were 'generally comparable' to those of the Investment Companies Act, whose jurisdictional provision contains the 'actions at law' language. S. Rep. No. 1775, 76th Cong., 3d Sess., at 23 (1940); H.R. Rep. No. 2639, 76th Cong., 3d Sess., at 30 (1940)." (Pet. App. 25-26).

(footnote continued from preceding page)

The House Committee on Interstate and Foreign Commerce reported out a bill identical to the Senate bill. H.R. 10065, 76th Cong., 3d Sess. The House Committee report also states that the sections of the Advisers Act dealing with "unlawful representations, administrative and enforcement machinery" contain "provisions comparable to those in" the Investment Company Act. H. Rep. No. 2639, 76th Cong., 3d Sess., p. 30.

These references in the legislative history hardly qualify as evidence that the Congress intended to prohibit private rights of action under the Advisers Act. Not only is there no language in the committee reports which even hints at such an intention; the jurisdictional provision of the Investment Company Act, to which the jurisdictional provision of the Advisers Act was intended to be "comparable", has been held to support a private right of action. See *Brown* v. *Bullock,* 194 F.Supp. 207 (S.D.N.Y.), *aff'd en banc,* 294 F.2d 415 (2d Cir. 1961).

Petitioners disagree with this analysis, which they themselves quote. However, it cannot be argued, as petitioners do, that the absence of expressly created private rights (and a jurisdictional section referring to actions at law to enforce them) indicates a Congressional intent to withhold private rights from those for whose benefit the statute was passed. That argument would lead to the illogical conclusion that no *implied* rights exist unless *express* rights are first granted. The law is otherwise. The doctrine of implied private rights of action arose precisely *because* statutes obviously designed to protect certain classes of persons omitted to provide those persons with express private remedies. See, e.g., *Texas & Pacific R.R. Co.* v. *Rigsby,* 241 U.S. 33 (1916).

Petitioners argue that the absence of provisions for express private remedies is itself an indication that the Congress intended to prohibit all private remedies. They argue that this conclusion flows from the fact that the Advisers Act was designed merely to effect a "compulsory census" of investment advisers (Pet. 11).

It is certainly true that the Advisers Act is a less complex, less pervasive regulatory enactment than the Exchange Act, for example. This, we think, accounts for the absence of expressly created private rights of action. That the legislation is simply less ambitious than other statutes, however, is no evidence at all that the Congress intended to prohibit private remedies for violations of the provisions it *did* enact, which have harmed those persons it *did* intend to protect. We know of no doctrine that private remedies may be implied only under the most pervasive regulatory schemes.*

* Indeed, the doctrine of implied remedies would seem more likely to be needed in connection with a less detailed statute.

In any event, the Act is more than a mere "compulsory census." This Court has held that "'avoiding frauds'" was one of its main purposes, *S.E.C.* v. *Capital Gains Research Bureau,* 375 U.S. 180, 195 (1963), and that it was one of the statutes having the "fundamental purpose" of requiring "a high standard of business ethics in the securities industry," *id.* at 186.

Finally, in addition to all of the above, Section 214 supports the implication of a private right of action by its very use of the word "violations." Section 214 gives the district courts "jurisdiction of violations of this subchapter . . ." Similar language is found in Section 27 of the Exchange Act, 15 U.S.C. § 78aa. It has been held, in litigation between private parties, that "violations" refers to civil as well as criminal proceedings. See, e.g., *Osborne* v. *Mallory,* 86 F.Supp. 869, 879 (S.D.N.Y. 1049):

> "Section 27 of the Securities Exchange Act of 1934 . . . gives a federal district court jurisdiction over 'violations of this chapter' . . . The word 'violation is not limited to a criminal case; it includes also civil litigation."

See also *Grossman* v. *Young,* 70 F. Supp. 970 (S.D.N.Y. 1947).

III

The decision and opinion below were the result of a considered analysis and application of principles outlined by this Court in its decisions. Contrary to petitioners' assertions, as the Court of Appeals noted, "the present case is plainly different in a significant legal respect from *National R.R. Passenger Corp.* v. *National Ass'n of R.R. Passengers,* 414 U.S. 452 (1974)". (Pet. App. 27, n. 22a at 28-29). In that case, Justice Brennan, concurring, noted,

"[T]he legislative history of the Amtrack Act provide[d] a clear and convincing expression of Congress' intent to preclude anyone except the Attorney General and in certain situations an employee or his duly authorized representative from maintaining an action under the Act against petitioners . . ." 414 U.S. at 465.

Moreover, the Supreme Court found that national transportation policies not pertinent here militated in favor of such a limitation. Here, however, no such history or policies can be found. The "clear and convincing" point to be extracted from the legislative history of the Advisers Act is that there is a total absence of any stated congressional intent to limit private rights of action thereunder. And, the policies behind the Advisers Act support the implication of a private right of an action.

Petitioners' casual treatment of *National R.R. Passenger Corp.* v. *National Ass'n of R.R. Passengers, supra,* is repeated in their consideration of the Court of Appeals' discussion of *Cort* v. *Ash,* 422 U.S. 66 (1975). *Cort* v. *Ash* specifies four factors relevant to the determination "whether a private remedy is implicit in a statute not expressly providing one." 422 U.S. at 78. Petitioners state that the Court of Appeals' decision refers to *Cort* v. *Ash* only "in passing" (Pet. 16), and that it "totally omits any point-by-point discussion of its four criteria, as Judge Gurfein points out in dissent (A39-40)." (Pet. 16-17). The Second Circuit's application of *Cort* v. *Ash* and its four factors has been discussed above (pp. 6-7), and we respectfully invite this Court's attention to that portion of the opinion below (Pet. App. 21-24). It will be seen that the Court below did in fact apply *Cort* v. *Ash* on a "point-by-point" basis. We note here only that Judge Gurfein nowhere points out any "omission" in his dissent; he dis-

agrees with the majority's view of the second factor listed in *Cort,* i.e., legislative intent, but does not fault their "point-by-point discussion."

Similarly, petitioners' selective quotation from *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1 (1977), hides the essential holding of that case. In *Piper,* Chief Justice Burger, writing for the majority, noted:

"[W]here congressional purposes are likely to be undermined absent private enforcement, private remedies may be implied in favor of the particular class intended to be protected by the statute." 430 U.S. at 25.

The Court then examined the legislative history of the Williams Act of 1968, 15 U.S.C. § 78n(e), and determined that Congress had intended to protect the shareholders of target companies by regulating takeover bidders. Chris-Craft, the defeated tender offeror, was not a member of the class Congress sought to protect. Accordingly, an implied right of action in favor of Chris-Craft was not necessary to effectuate Congress' goals. In the present case, however, as the Second Circuit found below and as the Fifth Circuit found in *Wilson* v. *First Houston Investment Corp., supra,* an implied private right of action *is* necessary to make effective the congressional purposes behind the Advisers Act.*

In reaching this conclusion, both the Court below and the Fifth Circuit in *Wilson* found this Court's pronouncements in *J.I. Case Co.* v. *Borak,* 377 U.S. 426 (1964), to be appli-

* The *Wilson* Court specifically stated, ". . . [T]he reasoning of *Piper* simply does not apply to the instant case where plaintiff is a member of the protected class" (p. 1242). And the Second Circuit in the case at bar cited *Piper* in support of its conclusion that the *Cort* v. *Ash* analysis requires "recognition of an implied right of action under Section 206 of the Advisers Act" (Pet. App. 22).

cable. In *Borak,* this Court, referring to an implied right of action under section 14(a) of the 1934 Act, pointed out that "Private enforcement . . . provides a necessary supplement to Commission action" (p. 432),* and stated (p. 433),

> "[I]t is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose."

The Court below found that the Commission's resources are too limited for it *"alone"* to be expected to provide effective enforcement of the Advisers Act (Pet. App. 20; emphasis added). The Commission itself has expressly taken a similar position. See *SEC Legislative Proposals Concerning Regulation of Investment Advisers,* SRLR No. 332 (BNA, December 17, 1975) pp. E-1 *et seq.,* wherein the Commission stated (p. E-7),

> "[P]rivate litigation would serve as a valuable adjunct to Commission enforcement action." **

There can thus be little doubt that "congressional purposes are likely to be undermined absent private enforcement" of the Advisers Act.

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* It is noteworthy that proxy soliciting material distributed under section 14(a) is actually filed with the SEC before it may be mailed. 17 C.F.R. § 240.14a-6. This is not true of the sort of annual and monthly reports by investment advisers claimed in this case to have contained false and misleading statements. If the SEC lacks the resources to act as sole enforcement agent as to violations contained in material actually filed with it, then the need for private enforcement as to unfiled materials is even greater.

** In this document, as petitioners point out, the SEC suggested adding the words "actions at law" to Section 214. But this was only to put to rest those few District Court decisions holding, on the basis of Section 214, that no private right of action exists. The Commission expressly stated that it believes Section 214, as presently written, supports a private right of action (p. E-7).

IV

Petitioners dispute the finding below that the general partners of an investment partnership are "investment advisers" within the scope of the Advisers Act.*

The Court below found that the general partners were investment advisers on two distinct grounds, both of which are correct, and one of which is not even challenged in the petitions. The discussion of the Court of Appeals may be found at Petitioners' Appendix pages 14-18. Having found that the general partners received compensation for managing the limited partners' investments**—and this is not denied by petitioners—the Court below then turned to the inquiry whether they were "engage[d] in the business of advising others" with respect to these investments:

> "On two independent grounds, we believe they were.
>
> "First, the monthly reports which contained the alleged fraudulent representations were reports which provided investment advice to the limited partners. The general partners' compensation depended in part upon the firm's net profits and capital

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* Section 202(a)(ii) of the Investment Advisers Act, 15 U.S.C. § 80b-2(a)(11)(1970), in relevant part provides:

> " 'Investment adviser' means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities . . . ."

** Each of the three partnership agreements in effect between 1965 and 1970 provided that the general partners would be paid for their services 20% of the firm's net profits and net capital gains for each fiscal year. In addition, the partnership agreement of October 1, 1968 authorized an annual salary of $25,000 for each general partner who managed investments (Pet. App. 14-15).

gains. These in turn were affected by the size of the total funds under their control. The monthly reports were an integral part of the general partners' business of managing the limited partners' funds. In deciding whether or not to withdraw their funds from the pool, the limited partners necessarily relied heavily on the reports they received from the general partners.

"Secondly, wholly aside from the monthly reports, we believe that the general partners as persons who managed the funds of others for compensation are 'investment advisers' within the meaning of the statute. This is borne out by the plain language of Section 202(a)(11) and its related provisions, by evidence of legislative intent and by the broad remedial purposes of the Act." (Pet. App. 15).

Petitioners conspicuously omit any discussion on this point of the legislative history of the Advisers Act. As noted by the Court below (Pet. App. 16-17), the SEC study which led to the adoption of the Advisers Act referred not only to investment advisers who made recommendations to clients, but also to investment advisers "with management powers over their clients' funds and the power to make purchases and sales for their clients . . . ." (Pet. App. 16). The Court of Appeals also observed (Pet. App. 16-17) that the Report of the Senate Committee on Banking and Currency which accompanied the bill to the Senate floor stated,

> "The report of the Commission to the Congress and the record before the committee is clear that the solution of the problems and abuses of investment advisory services—*individuals and companies which either handle pools of liquid funds of the public or give advice with respect to security transactions*—cannot be effected without Federal legislation."
>
> * * *

> "Virtually no limitations or restrictions exist with respect to the honesty and integrity of persons who may solicit funds to be *controlled, managed, and supervised.*" (Emphasis added.) S. Rep. No. 1775, 76th Cong., 3d Sess., 21 (1940).

There are, of course, other portions of the legislative history and other provisions in the Advisers Act itself* which lead to the same conclusion and which are discussed in detail in the opinion below (Pet. App. 15-18). We need not refer to them further.

There is also no substance to petitioners' purported fear of runaway extrapolation from these principles. Specifically petitioners claim (Pet. 19):

> "Under the rationale of the majority opinion below, not only general partners of investment partnerships but every compensated trustee, executor and other fiduciary with discretionary investment powers would be deemed an investment adviser" (Emphasis in original)

This fear, if real, is simply foolish. Many such trustees are banking institutions or lawyers and are specifically *exempted* from adviser status under the express provisions of Sections 202(a)(11)(A) and (B). Many other persons who are relatives or trusted friends of a decreased person, for example, and are serving as testamentary trustees, obviously cannot be said to be "in the business" of doing so, and hence are also excluded by definition from adviser status by express statutory language.

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* See Section 203(c)(1)(D), 15 U.S.C. § 80b-3(e)(1)(D), which requires an adviser's registration to disclose his "authority . . . with respect to clients' funds and accounts"; and see Section 205, 15 U.S.C. § 80b-5, which regulates advisory contracts under which the adviser will, among other things, "manage any investment or trading account . . ."

Still other trustees whose investment advising role is merely incidental to more significant functions may, if in doubt about their status, obtain relief from the SEC under Section 202(a)(11)(F), pursuant to which the SEC may by rule, regulation, or order add to the list of persons expressly exempted by the Congress ". . . other persons not within the intent of this paragraph." *

Petitioners, in support of their contention in this regard, claim that the holding of the Court of Appeals violates the "rule" that persons managing private and family investments are not in the "business of advising others" and are therefore not "investment advisers" under the Advisers Act. (Pet. 18)

There is no such rule and the authorities cited by petitioners do not support them. Thus, in *In the Matter of Augustus P. Loring, Jr.*, 11 S.E.C. 885, 1941-42 CCH Fed. Sec. L. Rep. Transfer Binder ¶ 75,299 (1942) (cited at Pet. 18n 21), the SEC granted an order of exemption to a "professional trustee" noting that the bulk of his business consisted of acting as a "court fiduciary . . . under the supervision of the courts," that services he performed went well beyond the supervision of investments and that "[a]ny advice given by applicant to others as to securities is solely incidental to his activity as a professional trustee."

The factors which moved the SEC to grant an exclusion in *Loring* have no parallel to the instant case, where the investment partnership's *sole* (not "incidental") attraction to investors was the presumed ability of its general partners to trade securities in a sophisticated and profitable manner.

* The SEC has recently exercised this power, exempting certain employee benefit plan trustees. See 17 C.F.R. § 275.202-1 (1976). It has also, on several occasions, ordered exemptions of specific persons in specific cases.

Significantly petitioners omit any mention of the SEC's recent ruling in *Brewer-Burner & Associates, Inc.*, 1973-74 CCH Fed. Sec. L. Rep. Transfer Binder ¶ 79,719 (1974). In *Brewer-Burner,* the inquiring company proposed to act as a "trustee" under the laws of Panama and intended to solicit American investors to establish with it *inter vivos* trusts which would invest in securities. The SEC advised (p. 83, 925),

> "In our opinion, the Panamanian trust company which is to act as trustee would be an investment adviser within the meaning of Section 202(a)(11) of the Advisers Act . . . Accordingly, registration under the Act would be required."

Interestingly, the SEC also cautioned that the trust company may be subject as well to registration under the Investment Company Act. *Brewer-Burner* is flatly inconsistent with petitioners' argument and plainly contradicts the supposed "rule".

Finally in this regard, we note the frequent use by petitioners of the words "private", "family investments", "investment entities for . . . their families and friends", and the like, to describe the investment vehicle involved here. That vehicle, however, had 35 limited partners by April 1, 1966, and had 66 limited partners by October 1, 1968 at which time it also had assets of approximately $60,000,000 (Pet. App. 7). The stress placed by petitioners on the supposedly "private" and intimate nature of the partnership is ill-advised; in 1968 it was larger than at least 87% of the limited investment partnerships surveyed in the SEC's *Institutional Investor Study Report* (1971) (see volume 2, p. 306). In fact, persons other than the general partners and their families owned nearly half the total capital on October 1, 1966 and on October 1, 1967, persons other than the general partners and their families owned over 60% of

the capital on October 1, 1968. Petitioners make their argument about the "privacy" and intimacy of the partnership without once referring to the *very provision of the Advisers Act that is designed to accommodate such considerations.* Section 203, which prescribes registration of investment advisers, further provides:

> "(b) The provisions of subsection (a) of this section [mandatory registration] shall not apply to
>
> * * *
>
> "(3) any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under subchapter I of this chapter."

By this paragraph, the Congress eased, to the extent it saw fit, the regulatory burdens on adviser activities such as those allegedly engaged in by the general partners here, activities which affect only a small number of people and do not involve solicitations of the public. The exemption is not from the definition of investment adviser or the antifraud rules of Section 206, but only from the requirement to register.

Thus, the Congress, in Section 203, clearly considered the very question now being raised by petitioners: whether a small number of clients, a "private" enterprise, and a lack of public solicitation should be sufficient to exempt an investment manager from the definition of "investment adviser." While petitioners urge that the Congress did not intend to regulate such persons under the Advisers Act, Section 203 makes it quite clear that the Congress felt only that such persons need not register. Congress clearly felt

that they should certainly be subject, however, to the antifraud provisions, which apply to all advisers, registered or unregistered.

V

Petitioner Harry Goodkin & Company ("Goodkin") has submitted a separate petition urging that the Court of Appeals erred in holding that Goodkin could be liable under the Advisers Act as an aider and abetter of the investment advisers. Goodkin argues that Section 206 applies only to investment advisers and that an accountant acting solely in the practice of his profession cannot be held liable thereunder. In making this argument, however, Goodkin seriously misstates the holding of the Court below.

In the first place, the Court of Appeals *agreed* that an accountant's usual activities are exempted from the scope of the Advisers Act. However, the Court of Appeals also held that an accountant may be held liable if he aids and abets an investment adviser *knowing* that the investment adviser is defrauding a client and *knowing* that his conduct is assisting that fraud:

> "[T]he exemption does not shield the accountant from liability under the antifraud provisions of the Act if the accountant aids and abets an investment adviser with *knowledge* that his conduct is assisting an investment adviser in defrauding a client. . . . In view of the limitation of Section 206 to investment advisers, however, we believe that before Goodkin can be held liable as an aider and abetter, there must be a showing that Goodkin: (a) knew of the investment adviser-client relationship; (b) had knowledge of the fraud; and (c) acted in concert with the investment adviser. Cf. *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976)." (Pet. App. 18n. 16; emphasis in original)

Nowhere does petitioner Goodkin acknowledge the severe restrictions imposed by the Court of Appeals on any attempt to hold an accountant liable under the Advisers Act. And nowhere does petitioner Goodkin acknowledge that the Court of Appeals has in fact found no one liable; it merely articulated a stringent standard by which to judge Goodkin's conduct at a subsequent trial:

> "Whether Goodkin is liable for aiding and abetting the investment advisers is one of the issues to be determined at trial pursuant to our remand." (Pet. App. 18 n.16)

VI

Finally, petitioners challenge the guidance on damages given by the Court of Appeals to the District Court upon remand of the action. Petitioners charge that this formulation "conflicts with the basic rule of damages under the federal securities laws (Pet. 19)", "will permit plaintiffs . . . to isolate securities on which profits are reaped from those on which there are losses (Pet. 20)", and will "assure a flood of claims under the Advisers Act (Pet. 21)."

None of these charges is true. None of them takes into account the fundamental differences between the fiduciary relationship between an invetsment adviser and his client and an arms-length purchase or sale transaction. None of them considers the circumspect care exercised by the Court of Appeals to prevent either windfall profits or "a flood of claims".

At the outset we note that petitioners have abandoned their reliance on *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), in support of their position on this point. See Pet. App. 29-31. Nevertheless, they continue to insist, without analysis or thoughtful consideration, that

"the basic rule of damages under the federal securities laws" is somehow violated. We assume petitioners are referring to a "basic rule" for damages under Rule 10b-5. But the fact is that Section 206 of the Advisers Act was intended to protect the integrity, not merely of an event such as a purchase or sale,* but of a *relationship.* That relationship, moreover, is a *fiduciary* relationship. *SEC* v. *Capital Gains Research Bureau,* 375 U.S. 180 (1963). It is for this reason, we submit, that Section 206 prohibits *all* fraud practiced by an adviser upon his client, and not merely frauds practiced in connection with the purchase or sale of a security.**

Petitioners' other arguments on this point are equally meritless. The Court below specifically and expressly held that a plaintiff may not recover for his losses but ignore his profits:

> "This is not to say, however, that a plaintiff may recover for losses, but ignore his profits, where both result from a *single* wrong". (Pet. App. 32; emphasis in original)

The measure of damages formulated by the Court of Appeals is as follows:

---

* Holding petitioners' reliance on *Blue Chip* "misplaced," the Court below said (Pet. App. 29),

> "The *Blue Chip* decision was based on the *express language* of Section 10(b) and Rule 10b-5 requiring a fraud 'in connection with the purchase or sale of any security.' " (Emphasis in original)

** The damage formula below was not "in derogation of the common law." Cf. *SEC* v. *Capital Gains Research Bureau, supra,* 375 U.S. 180, 192. See, e.g., *First Trust of Lincoln* v. *Carlson,* 131 Neb. 325, 268 N.W. 89 (1936), which makes fiduciaries liable on a similar basis for breaches of duty. See also III *Scott on Trusts* § 205; *Bogert on Trusts* § 862; Restatement, Trusts 2d, §§ 205, 206.

"In determining on remand whether plaintiffs have sustained any damages from the alleged fraudulent investments, the district court should determine, first, at what point defendants' representations became fraudulent due to the increasing proportion of portfolio investments in unregistered securities. The court then should compute the total net losses on all holdings of unregistered securities due to changes in price *after* that date. Finally, the court should determine what proportion of FBA's holdings was inconsistent with representations that the partnership was in a 'most conservative posture' and the other representations made to the limited partners. The proper measure of damages then would be that part of net losses incurred on unregistered securities after the point when the defendants' representations became fraudulent which stems from the portion of those investments inconsistent with defendants' representations." (Pet. App. 32-33; emphasis in original; footnote omitted).

Petitioners' fears that the courts will be subjected to "a flood of claims" are plainly unfounded. As the Second Circuit noted, under Section 206, the plaintiff class is limited to "the investment adviser's own clients."* (Pet.

* It is true that Section 206 also prohibits fraud on a "prospective client." We think this language would support a private right of action for damages only where the prospective client was induced by fraud to become an actual client, and suffered damage as a result. In the case at bar, the plaintiffs became and at all pertinent times were actual clients. The SEC, of course, could seek sanctions against advisers who have solicited "prospective clients" through fraud.

Petitioners also argue that the duty of a fiduciary, under the decision below, is "overbroad." They say that the decision below supports a right of action under Section 206 for "non-disclosure" (Pet. 9 n.9). Petitioners overlook the fact that this Court rejected precisely

(footnote continued on following page)

App. 31). Moreover, the damages claimed cannot be considered speculative. Since the client pays the investment adviser for his services, both client and adviser understand that the client will rely upon the adviser's judgment and advice. As the Court of Appeals found:

> "We believe that the limited uncertainties involved in a case such as this are not sufficient to to bar recovery on an otherwise valid claim; and they are adequately offset by requiring proof that the misrepresentations were material and proof of reliance." (Pet. App. 31).

We note in conclusion that the Court of Appeals nowhere held that respondents had in fact suffered any damages at all. Respondents have simply been given an opportunity to prove their claim:

(footnote continued from preceding page)

this argument in *SEC* v. *Capital Gains Research Bureau, supra,* 375 U.S. 180, 197. This Court said that, in all likelihood, the Congress "deemed a specific prescription against non-disclosure surplusage" (p. 199). The Court also said, "Failure to disclose material facts must be deemed fraud or deceit within its [the Advisers Act's] intended meaning . . ." (p. 200).

Finally, petitioners suggest that the decision below would permit recovery for a negligent misrepresentation. They argue that Section 206 and Rule 206(4)-1(a)(5) would permit this. Petitioners thus overlook two important facts: First, the complaint in this case alleges that the misrepresentations were intentional (see Pet. App. 32 n.26). Secondly, the Court below specifically disclaimed any intention of ruling on whether negligent misrepresentation may support an Advisers Act claim. The Court said (Pet. App. 32 n.36),

> "It is important to note that there is no issue in this case as to whether an investor may recover for negligent misrepresentations by his investment advisor. . . . Petitioners here have alleged that the defendants' misrepresentations were *intentional*. . . . [T]hey [the general partners] would be liable under Section 206 if they *intentionally* deceived the limited partners . . ." (emphasis in original).

> "We of course do not intimate *any* views as to whether plaintiffs in fact have sustained any damage and, if so, *how much.* All we hold is that they are entitled to their day in court and an opportunity to prove, if they can, their claim under the Advisers Act." (Pet. App. 33; emphasis in original).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

October Term, 1977

No. 77-1279

MALCOLM K. FLESCHNER, WILLIAM J. BECKER, HAROLD B. EHRLICH and FLESCHNER BECKER ASSOCIATES,

Petitioners,

v.

ROBERT ABRAHAMSON and MARJORIE ABRAHAMSON,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONERS' REPLY BRIEF

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May 4, 1978

IN THE

Supreme Court of the United States

October Term, 1977

No. 77-1279

MALCOLM K. FLESCHNER, WILLIAM J. BECKER, HAROLD B. EHRLICH, and FLESCHNER BECKER ASSOCIATES,

Petitioners,

v.

ROBERT ABRAHAMSON and MARJORIE ABRAHAMSON,

Respondents.

PETITIONERS' REPLY BRIEF

Petitioners Malcolm K. Fleschner, William J. Becker, Harold B. Ehrlich and Fleschner Becker Associates submit this brief in reply to the Brief for Respondents in Opposition submitted on behalf of respondents Robert and Marjorie Abrahamson.[1]

The implication of a private right of action for damages under the Investment Advisers Act of 1940, only after almost 40 years' experience with a statute of extremely limited length, scope and objectives, is hardly "inevitable," as respondents claim (Br. 8). The entire court below found there to be no claim stated under Section 10(b) of the Securities Exchange Act of 1934, but the majority avoided the implications of this conclusion by holding that the same allegations did state a claim for relief under a novel implied right of action under the Advisers Act.

[1] References to the brief filed by respondents are indicated by the designation "Br." preceding a page citation.

I.

The question of whether a private action for damages may be implied under the Advisers Act is one that has deeply divided the federal courts. The three Courts of Appeals to have implied such a right of action have done so only over strenuous dissenting opinions and after reversing the District Courts below.[2]

The court below improperly formulated a legislative issue with respect to the Advisers Act: "whether there should be a private right of action to recover damages" (A27). Directly contrary to the legislative history and the admittedly limited regulatory scheme imposed by the Act, respondents and the majority below alike have imputed to the 1940 legislation "broad remedial purposes" on imagined congressional findings of widespread abuses by investment advisers. On these hypotheses—both false—the implication of a private right of action for damages is characterized as a fulfillment of unexpressed congressional intent, rather than naked judicial usurpation of a wholly legislative function.

In *Cort* v. *Ash*, 422 U.S. 66 (1975), this Court articulated four factors to instruct and guide the lower courts in determining whether a private right of action may be implied in a federal statute where such a private right is not expressly provided for. By fundamentally misconstruing the purposes behind the Advisers Act, respondents and the majority below have given a wholly inadequate analysis of these *four* criteria. *Cort* is turned on its head by respondents' conclusion (*e.g.*, Br. 14, 16) that private rights of action for damages should be implied unless Congress clearly and convincingly expressed its intent to withhold or limit such rights. Judge Timber's statement—that he "hesitate[d] to reach such a result absent clear evidence from the Act's legislative history that private actions were not intended" (A23)—is nothing short of a manifest refusal to give a balanced consideration to the four factors, which we treat herein beginning with those factors that the court below brushed aside in order to create such private damage actions in the face of affirmative evidence of Congress' contrary intent.

[2] See opinions below and *Wilson* v. *First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir., Feb. 2, 1978).

On April 19, 1978 the Court of Appeals for the Ninth Circuit in *Lewis* v. *Transamerica Corp.*, reversing the District Court (2-1; Wallace, J. dissenting), implied a private right of action. Neither the majority nor dissenting opinions independently analyzed the underlying issues, but rather merely adopted the arguments made in the majority and dissenting opinions of the Second Circuit in this case. We have been advised that appellees intend to file by May 5, 1978 a petition for a writ of certiorari to review the Ninth Circuit's order, with a motion to expedite consideration of the petition so that these two cases may be treated together.

A. "The Underlying Purposes of the Legislative Scheme."

Unlike other securities laws the 1940 Advisers Act was not promulgated on the strength of any finding of pervasive abuses—among investment advisers or otherwise. To the contrary, the legislative history shows that it was the absence of adequate information about advisers that was the principal focus of the Act. A "compulsory census" through registration was sought as the "basic approach" of the Act to make possible an "intelligent . . . appraisal of the economic function or the abuses which *might* exist" (testimony of David Schenker for the SEC in the Senate Hearings) (emphasis added).[3]

[3] *Hearings on S. 3580 before the Subcomm. of the Senate Comm. on Banking & Currency*, 76th Cong., 3d Sess. 48 (1940). *See also* S. Rep. No. 1760, 86th Cong., 2d Sess., U.S. Code Cong. & Adm. News 3502 (1960).

With recognition of its general ignorance of the so-called investment advisers industry, then in its infancy, Congress did not presume to know the ills of the industry, and it accordingly did not prescribe an elaborate regulatory scheme with extensive administrative and judicial controls as a cure. The Act did not have "broad remedial purposes." We submit, contrary to respondents' suggestion, that it is no accident that "the Advisers Act is a less complex, less pervasive regulatory enactment than the Exchange Act" (Br. 14), and likewise no accident that the latter has numerous expressly stated rights of action for damages and the former none at all.

The assertion of the majority below (A23) that the denial of a private right of action for damages would "effectively frustrate" the underlying congressional purpose is simply untenable in light of the Act's informational goals through registration. *See also* Br. 17. Moreover, although the Advisers Act was enacted almost forty years ago, only within the last few years has there been any attempt on the part of plaintiffs to have a private right of action for damages implied under any section of the Act. This is because the other federal securities laws and state laws have afforded ample relief to injured parties suffering actual out-of-pocket damages.

Indeed, to imply an open-ended private right of action for damages under the Advisers Act would conflict with a fundamental congressional purpose in the federal securities laws, which were enacted to afford relief to persons who were defrauded in the purchase or sale of securities. *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975). As Judge Gurfein noted in dissent, to accord a private right of action for damages under the Advisers Act, especially to persons who have reaped huge profits and have neither bought nor sold any securities, is to

give such persons "*carte blanche* to convert themselves from victims to defrauders" (A45).

B. "Indication of Legislative Intent"

It is claimed that Congress was completely silent on the question of private rights of action under the Act (Br. 13-14; A25-26). Respondents argue that "Congressional intent to withhold private rights" cannot be inferred from "the absence of expressly created private rights (and a jurisdictional section referring to actions at law to enforce them)" (Br 14). Such reasoning is a complete inversion of the proper inquiry required by *Cort* as to whether there is evidence of an intent affirmatively to legislate a new federal claim.[4]

Furthermore, rarely has congressional intent to deny a private right of action been clearer from the legislative history. First, the Advisers Act, alone of all the federal securities statutes, nowhere contains any section expressly providing a civil action for damages. Second, the Act's jurisdiction section (Section 214), similarly unique in federal securities law, confers upon the district courts jurisdiction only of "violations" and "suits in equity to enjoin any violation." Respondents concede that the language of § 214 is "not quite the same as" the jurisdictional sections in all the other federal securities acts (Br. 10-11), but dismiss the affirmative deletion of the phrase "actions at law" from the jurisdictional grant of § 214 with an appeal to the absence of any express right—a *non sequitur* made even less persuasive by the fact that none of the

[4] This Court has repeatedly affirmed the principle of legislative construction that "when a statute limits a thing to be done in a particular mode, it includes the negative of any other mode", *Botany Mills* v. *United States,* 278 U.S. 282, 289 (1929). *See also National Railroad Passenger Corp.* v. *National Ass'n of Railroad Passengers,* 414 U.S. 453, 458 (1974), and *Securities Investor Protection Corp.* v. *Barbour,* 421 U.S. 412, 419 (1975).

drafts of the Advisers Act had any express provision for a right of action. The striking of the jurisdictional phrase "actions at law" from the original SEC drafts after industry participation must accordingly be accounted for on its own terms.[5] Third, Congress has had since 1940 three opportunities to include a provision for civil liability under the Advisers Act and each time Congress has failed to include such a provision. Respondents completely ignore this subsequent legislative history and instead rely on a passage in the Senate Committee Report concerning the Investment Company Act and the Investment Advisers Act that the Advisers Act " 'contains provisions generally comparable to those of' the Investment Company Act" (Br. 12 n.), which completely begs the question. *See* A38 n. 6.

C. The Alleged "Cause of Action is One Traditionally Relegated to State Law, in an Area Basically the Concern of the States."

Respondents prove the point made in our petition (Pet. 7-8) that the delineation of the cause's parameters would continue to trouble the courts, and invade the traditional province of state law. They would have the new right of action subsume the entire law of trusts, in derogation of actions "traditionally relegated to state law, in an area basically the concern of the States" (*Cort* v. *Ash,* 422 U.S. at 78):

> "Section 206 of the Advisers Act was intended to protect the integrity, not merely of an event such as a purchase or sale, but of a *relationship*. That relationship, moreover, is a *fiduciary* relationship. It is for this reason, we submit, that Section 206 prohibits *all* fraud practiced by an adviser upon his client, and not merely frauds practiced in connection with the purchase or sale of a security." (Br. 27) (footnotes and citation omitted) (emphasis in original)

[5] As an afterthought, respondents try to avoid the clear implication of the deletion of the "actions at law" language by emphasizing the use of the word "violations" in Section 214. Even the majority was unprepared to give any weight to this section (A26 n. 22) and Judge Gurfein in his dissent correctly pointed out that " 'violations' in the context means criminal violations, and violations on the civil side are limited to suits in equity" (A36 n. 4). Respondents' argument also ignores the fact that each of the other five securities laws expressly confirm jurisdiction on both "violations" and "actions at law".

There could not be a clearer expression of the hazards inherent in the majority's legislation of an unbounded new cause of action.

D. There was no Single Class for Whose "*Especial* Benefit" the Statute was Enacted.

In light of these three factors, wholly ignored in the majority opinion, it is clear that the Advisers Act singled out no one class of persons for *especial* benefit. The Act's modest informational objectives and the failure of the legislative history to support any findings of pervasive industry abuses is inconsistent with judicial designation of any such beneficiaries.

Indeed, it is ignored, in the legislative history cited by the majority itself, that the Act was not just for the benefit of clients of unscrupulous investment advisers, but "to safeguard the honest investment adviser against the stigma of the activities of these individuals" (A22 n. 18). Such a goal is completely consistent with enforcement of the Act only by suits in equity by the Commission.

II.

The tension between the assertions of law and the claims for money damages made by respondents is nowhere more evident than on the question of whether the individual petitioners here were "investment advisers." As a predicate to the applicability of the Advisers Act, respondents claim that

the petitioners were their advisers; but the wrong alleged, on the other hand, is that the general partners did not advise respondents on any of the investments made by them. As general partners of the partnership, they had broad discretionary authority under the partnership agreement, with exclusive powers of management of the partnership's assets as a matter of state law (*see* A34 n. 1). Respondents ignore the facts that the partnership agreement made no provision for the rendering of any advice based on the individual needs or preferences of any limited partner, and that the assets of the partnership were pooled for all purposes, including investment.[6]

Likewise, respondents have wrongly leaped from the fact that the individual petitioners engaged in the business of investment to the very different conclusion that they *advised others* on investments and were thus "investment advisers" under the Act.[7] The original conclusion of the majority

[6] As noted by Judge Gurfein (A45-46): "In this very case the [respondents] received profits from the restricted letter stock and waited almost a full year until the market became unfavorable before seeking redemption of their shares. They deliberately entered into a partnership that was going to operate in the most speculative of investment activities. They gave the general partners the power to invest in any kind of security, to sell short and cover both securities and commodities, to buy and sell options and to cover, to play the commodities market, to buy on margin, to lend money to partners without security, and to pledge partnership assets for loans. * * * Even a babe in the woods would know that he was giving his money to the general partners for discretionary speculation. The purchase of unregistered stock, far from being unforeseeable, fits quite well into this plan. * * * Given the purposes of the hedge fund and the broad powers vested in the general partners, it is hardly likely that the plaintiffs were interested in evaluating the portfolio themselves. Indeed, the plaintiffs never asked for a list of the securities held by the partnership."

[7] Respondents cite Brewer-Burner & Associates, Inc., [1973-1974 Transfer Binder] Fed. Sec. Rep. (CCH) ¶ 79,719 (1974), and imply that it is a "recent ruling" of the full Commission (Br. 23). To the contrary, it is a staff no-action letter, unlike the formal *contra* rulings of the full Commission cited by petitioners (Pet. Br. 18 n. 21).

below, that the individual petitioners advised the limited partners, was implicitly repudiated in its subsequent order on the petitions for rehearing, which withdrew the conclusion that the general partners as individuals were "investment advisers *to the limited partners*" (A51). The inference thus left—that they were only "investment advisers" to the partnership itself—is also unsustainable, since as the general partners of the partnership they had legal title to its assets, sole power to manage the partnership (as well as very substantial personal interests in the partnership and ever greater interests as trustees for their families), and would accordingly have to be found to be investment advisers to themselves, a result surely not contemplated by the statute.[8]

CONCLUSION

Under the Second Circuit's opinion respondents would be allowed to prosecute under the Advisers Act a claim for money damages based solely on their own assertions of their personal investment preferences and what they "would have done," although they in fact obtained a 48% return on their investment. These same allegations were held not to state a claim for relief under Section 10(b) of the Securities Exchange Act, in reliance on *Blue Chip Stamp* v. *Manor Drug*

[8] Respondents also endorse the majority's conclusion that brief monthly reports issued by the partnership were "reports which provided investment advice to the limited partners" (A15; *see* Br. 19-20). Yet it is conceded that the reports made no reference to any particular security, or the advisability of investing in securities, and were only "concise, two paragraph statements which set forth the percentage increase or decrease in value of the firm's investments for the year to date and compared the investments with Standard & Poor's "500 Stock Average" (A8). A document giving a single figure for the net performance of dozens of securities and other investments hardly constitutes investment advice.

Stores, 421 U.S. 723, 737-38 (1975). The potential for abuse in this alleged new cause is thus made clear in this very case.

For the reasons set forth in the petition and this reply brief, a writ of certiorari should issue to the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

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May 4, 1978

IN THE

Supreme Court of the United States

October Term, 1977

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Petitioners,

vs.

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OCTOBER TERM, 1977

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MOTION OF INVESTMENT COUNSEL ASSOCIATION OF AMERICA, INC. FOR LEAVE TO FILE A BRIEF AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI.

Pursuant to Rule 42 of the Rules of the Supreme Court of the United States, the Investment Counsel Association of America, Inc. ("ICAA") hereby moves for leave to file a brief as *amicus curiae* in support of the petition for writ of certiorari filed by petitioners, Malcolm K. Fleschner *et al.* Counsel for respondents Robert Abrahamson and Marjorie Abrahamson declined to consent to the ICAA's filing of an amicus brief, on the basis that the timing of the request for consent was such that he would not have sufficient time to respond.

The ICAA was organized in 1937 as an association of those investment advisers engaged in rendering investment counsel services to clients. The 79 member firms constitute virtually all of the larger and many of the smaller firms registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940 ("Act") who are independent of the banking and brokerage industries and render continuous portfolio supervision and advice to clients on the basis of their individual needs and circumstances.

The ICAA has no interest in the essentially private aspects of the dispute. Its concern is with the creation of a new, undefined private right of action against investment advisers. The ICAA was an important participant in the hearings and negotiations that culminated in the industry draft that became the Act. It therefore feels that it is uniquely qualified to assist the Court in its review of the Act's legislative history.

The United States Court of Appeals for the Second Circuit recognized the "importance and novelty" (A78)[1] of its decision to imply a private right of action under the Act. That decision, arrived at over a vigorous dissent, should not stand without review. It affects an industry which the Securities and Exchange Commission recognizes has "substantial impact . . . on both the economy and the public investor. . . ."[2] The ICAA believes that the decision is premised on a misreading of the Act's legislative history.

1. References "A ...." are to pages of the Appendix to petition for writ of certiorari of petitioners Malcolm K. Fleschner, William J. Becker, Harold B. Ehrlich and Fleschner Becker Associates.

2. Statement of the Securities and Exchange Commission in Support of Proposed Amendments to the Investment Advisers Act of 1940, transmitted to Congress by Chairman Hills in December, 1975. (Legislation to Amend Investment Advisers Act of 1940 Proposed by the Securities and Exchange Commission, Investment Advisers Act Release No. 491 (December 15, 1975), [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶80,341).

The ICAA therefore respectfully prays that the Court grant this motion for leave to file its brief in support of the petition for writ of certiorari.

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IN THE

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OCTOBER TERM, 1977

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MARJORIE ABRAHAMSON,

Respondents.

BRIEF OF INVESTMENT COUNSEL ASSOCIATION OF AMERICA, INC., AMICUS CURIAE, IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI.

This brief is submitted on behalf of the Investment Counsel Association of America, Inc. ("ICAA") as *amicus curiae* in support of the petition for writ of certiorari of Malcolm K. Fleschner, William J. Becker, Harold B. Ehrlich and Fleschner Becker Associates.

The ICAA was organized in 1937 as an association of those investment advisers engaged in rendering investment counsel services to clients. The 79 member firms of the ICAA constitute virtually all of the larger and many of the smaller firms registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940 ("Act") who are independent of the banking and brokerage industries and render

continuous portfolio supervision and advice to clients on the basis of their individual needs and circumstances.

The ICAA has no interest in the essentially private aspects of the dispute. Its concern is with the creation of a new, undefined private right of action against investment advisers. The ICAA was an important participant in the hearings and negotiations that culminated in the industry draft that became the Act. It therefore feels that it is uniquely qualified to assist the Court in its review of the Act's legislative history.

ARGUMENT.

When the Act became law in 1940, it made no provision for a private right of action. As the majority opinion below recognized,[1] there was no statement in the legislative history indicating that Congress even considered the question of a private action. The Act was viewed as fundamentally "a compulsory census."[2] Section 214 of the Act granted jurisdiction to the district courts to hear criminal prosecutions and "suits in equity to enjoin any violation of this subchapter"; it made no provision for "actions at law." Twenty years later, Congress amended the Act extensively, strengthening the SEC's enforcement powers.[3] No change to § 214 was proposed[4] and no change was made. In 1970 the Act was amended again; its companion statute, the

1. A23. References "A ...." are to pages of the Appendix to the petition for writ of certiorari.

2. *Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess. (1940)* [*hereinafter "Senate Hearings"*] *at 48.*

3. The following sections of the Act were amended in 1960: 202(a)(12), 202(a)(18), 203(c)(1)(f), 203(c)(2), 203(d), 203(e), 203(g), 204, 205, 206, 208 [caption], 208(c), 209(e), 210(b), 211(a), and 217. Three sections or subsections were added: 206(4), 208(d) and 222.

4. The SEC made "extensive proposals." S. REP. No. 1760, 86th Cong., 2d Sess. 2 (1960).

Investment Company Act, was also amended. While a carefully delimited express right of action against an investment adviser to a mutual fund was added to the Investment Company Act,[5] no provision for jurisdiction over "actions at law" was added to the Act. Finally, in 1975 the SEC proposed that § 214 be amended to add "actions at law brought to enforce any liability or duty created by [the Act]"[6] and hearings were held on that proposal.[7] However, no change was made.

Thus, in contrast to all of the other federal securities acts,[8] the Act has never provided for jurisdiction over "actions at law." At no time has Congress evidenced any intent that the Act should form the basis for such an action.

The history of the birth of the Act is equally compelling. Early drafts contained, either directly or by reference, language regarding "actions at law."[9] These were opposed by the industry[10] and negotiations between the industry and the SEC

5. Section 36(b), Investment Company Act.

6. Investment Advisers Act Release No. 491 (December 15, 1975), [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80, 341.

7. *Investment Advisers Act Amendments: Hearings on S. 2849 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs,* 94th Cong., 2d Sess. (1976); *Investment Advisers Act Amendments: Hearings on H.R. 13737 Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce,* 94th Cong., 2d Sess. (1976).

8. Securities Act of 1933, Section 22, 15 U.S.C. § 77v; Securities Exchange Act of 1934, Section 27, 15 U.S.C. § 78aa; Public Utility Holding Company Act of 1935, Section 25, U.S.C. § 79y; Trust Indenture Act of 1939, Section 322, 15 U.S.C. § 77vvv; and Investment Company Act of 1940, Section 44, 15 U.S.C. § 80a-43.

9. *See, e.g.,* S. 3580, 76th Cong., 3d Sess. 98 (introduced by Sen. Wagner on March 14, 1940); H. R. 8935, 76th Cong., 3d Sess. 98 (introduced by Cong. Lea on March 14, 1940).

10. *Investment Trusts and Investment Companies: Hearings on H. R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce, 76th Cong., 3d Sess. (1940)* [*hereinafter "House Hearings"*] *at 88-90, 92; Senate Hearings at 712-723, 737-54.*

ensued.[11] The ICAA played an important role in those negotiations and in the drafting that followed. The result was an industry draft that had deleted any references to jurisdiction over "actions at law" or to "liability". With those deletions the draft became the Act:

> "In connection with the investment advisers, I think that Robert Page who represented Scudder, Stevens & Clark . . . submitted a draft of the bill to us, which is the draft that is included in this new bill."[12]

In short, the history of the Act—both in its birth and development—demonstrates that Congress never intended to create a private right of action under the Act.

The Act reflects a deliberate Congressional balance of the interests of the investment advisory industry and the interests of its clients.[13] That balance is destroyed in the Second Circuit's opinion that must,[14] but cannot, find support in the Act's legislative history. In its place, the Second Circuit would create a "claim for relief without limitation" (A44), an undefined cause of action that the federal courts will have to fashion through countless lawsuits. This should not be permitted. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U. S. 723 (1975).

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11. *House Hearings* at 88-90, 92; S. REP. No. 1775, 76th Cong., 3d Sess. 21 (1940).

12. *Senate Hearings* at 1124.

13. S. REP. No. 1775, 76th Cong., 3d Sess. 20-21 (1940) (Remarks of Rep. Wolverton).

14. *Ernst & Ernst* v. *Hochfelder*, 96 S. Ct. 1375, 1389 (1976).

CONCLUSION.

For the foregoing reasons, the petition for writ of certiorari by Malcolm L. Fleschner, William M. Becker, Harold B. Ehrlich and Fleschner Becker Associates should be granted.

Respectfully submitted,

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